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SELECT CASES

AND

OTHER AUTHORITIES

ON THE LAW OF

PRIVATE CORPORATIONS

BY

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PREFACE.

The first edition of Cases on Corporations was published seven years ago. In this second edition there are large changes.

The following subjects are considered at much greater length: Unincorporated Associations; Issues of Stock at a Discount or for Overvalued Property; Offenses Against the Sherman Anti-Trust Act; Reorganizations of Corporations.

The more important cases decided since 1909 are set forth, or cited in the notes.

There are numerous notes by the editor.

E. H. W.

LANGDELL HALL, CAMBRIDGE,
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BOOK I.

THE NATURE OF A CORPORATION.

CHAPTER I.

THE FORMATION OF A CORPORATION.

A. Necessity of Authority from the State.

BLACKSTONE, COMMENTARIES.

Book I, pp. 468, 469, 470, 472, 473.

The honor of originally inventing these political constitutions entirely belongs to the Romans. They were introduced, as Plutarch says, by Numa; who finding, upon his accession, the city torn to pieces by the two rival factions of Sabines and Romans, thought it a prudent and politic measure to subdivide these two into many smaller ones, by instituting separate societies of every manual trade and profession. They were afterwards much considered by the civil law, in which they were called *universitates* as forming one whole out of many individuals; or *collegia*, from being gathered together: they were adopted also by the canon law, for the maintenance of ecclesiastical discipline; and from them our spiritual corporations are derived. But our laws have considerably refined and improved upon the invention, according to the usual genius of the English nation: particularly with regard to sole corporations, consisting of one person only, of which the Roman lawyers had no notion; their maxim being that "*tres faciunt collegium.*" Though they held, that if a corporation, originally consisting of three persons, be reduced to one, "*si universitas ad unum redit,*" it may still subsist as a corporation, "*et stet nomen universitatis.*"

Before we proceed to treat of the several incidents of corporations, as regarded by the laws of England, let us first take a view of the several sorts of them; and then we shall be better enabled to apprehend their respective qualities.

The first division of corporations is into *aggregate* and *sole.* Corporations aggregate consist of many persons united together into one society, and are kept up by a perpetual succession of members, so

as to continue forever: of which kind are the mayor and commonalty of a city, the head and fellows of a college, the dean and chapter of a cathedral church. Corporations sole consist of one person only and his successors, in some particular station, who are incorporated by law, in order to give them some legal capacities and advantages, particularly that of perpetuity which in their natural persons they could not have had. In this sense the king is a sole corporation; so is a bishop; so are some deans, and prebendaries, distinct from their several chapters; and so is every parson and vicar. And the necessity, or at least use, of this institution will be very apparent, if we consider the case of a parson of a church. At the original endowment of parish churches, the freehold of the church, the churchyard, the parsonage house, the glebe, and the tithes of the parish, were vested in the then parson by the bounty of the donor, as a temporal recompense to him for his spiritual care of the inhabitants, and with intent that the same emoluments should ever afterwards continue as a recompense for the same care. But how was this to be effected? The freehold was vested in the parson; and, if we suppose it vested in his natural capacity, on his death it might descend to his heir, and would be liable to his debts and encumbrances: or at best, the heir might be compellable, at some trouble and expense, to convey these rights to the succeeding incumbent. The law therefore has wisely ordained, that the parson, *quatenus* parson, shall never die, any more than the king; by making him and his successors a corporation. By which means all the original rights of the parsonage are preserved entire to the successor; for the present incumbent, and his predecessor who lived seven centuries ago, are in law one and the same person; and what was given to the one was given to the other also. . . .

Corporations, by the civil law, seem to have been created by the mere act, and voluntary association of their members: provided such convention was not contrary to law, for then it was *illicitum collegium*. It does not appear that the prince's consent was necessary to be actually given to the foundation of them; but merely that the original founders of these voluntary and friendly societies, for they were little more than such, should not establish any meetings in opposition to the laws of the state.

But, with us in England, the king's consent is absolutely necessary to the erection of any corporation, either impliedly or expressly given. The king's implied consent is to be found in corporations which exist by force of the *common law*, to which our former kings are supposed to have given their concurrence; common law being nothing else but custom, arising from the universal agreement of the whole community. Of this sort are the king himself, all bishops, parsons, vicars, churchwardens, and some others; who by common law have ever been held, as far as books can shew us, to have been corporations, *virtute officii:* and this incorporation is so inseparably

annexed to their offices, that we cannot frame a complete legal idea of any of these persons, but we must also have an idea of a corporation, capable to transmit his rights to his successors at the same time. Another method of implication, whereby the king's consent is presumed, is as to all corporations by *prescription*, such as the city of London, and many others, which have existed as corporations, time whereof the memory of man runneth not to the contrary; and therefore are looked upon in law to be well created. For though the members thereof can shew no legal charter of incorporation, yet in cases of such high antiquity the law presumes there once was one; and that by the variety of accidents which a length of time may produce, the charter is lost or destroyed. The methods by which the king's consent is expressly given are either by act of parliament or charter. By act of parliament, of which the royal assent is a necessary ingredient, corporations may undoubtedly be created: but it is observable, that, till of late years, most of these statutes which are usually cited as having created corporations do either confirm such as have been before created by the king, as in the case of the College of Physicians, erected by charter 10 Hen. VIII, which charter was afterwards confirmed in parliament; or they permit the king to erect a corporation *in futuro* with such and such powers, as is the case of the Bank of England, and the society of the British Fishery. So that the immediate creative act was usually performed by the king alone, in virtue of his royal prerogative.

All the other methods, therefore, whereby corporations exist, by common law, by prescription, and by act of parliament, are for the most part reducible to this of the king's letters patent, or charter of incorporation.

NOTE. — From very early times the courts recognized some corporations as existing by force of the common law alone. See Y.B. 11 Hen. IV, 2; Y.B. 37 Hen. VI, 30; Y.B. 8 Edw. IV, 6; Y.B. 20 Edw. IV, 12; Y.B. 14 Hen. VIII, 2; Co. Lit. 3a; Finch's Law, c. XVII; Keilw. 32a; 2 P. Wms. 125; 4 Vin. Abr. 525. There is also evidence tending to show that, in early times, the Court of Exchequer, in revenue matters, allowed unchartered bodies of men to be sued, and even to sue, as a unit. Madox, Firma Burgi, 85, 91.

"Anciently a Gild either Religious or Secular could not legally be set-up without the Kings Licence. If any Persons erected a Gild without Warrant, that is, without the Kings leave, it was a Trespass, and they were lyable to be punished for it. For example. In the Twenty-sixth year of K. Henry II (1179), several Gilds in London were amerced to the Crown as Adulterine, that is, as set-up without Warrant from the King." Madox, Firma Burgi, 26.

In De Libertates, Lib. II, c. 24, fol. 56, Bracton puts the case that the king should grant some liberty "*ut si alicui universitati, sicut*

civibus vel burgensibus vel aliquibus alis q. mercatum habeant." It appears, from the chapter as a whole, that he considered this liberty, or franchise, together with various other liberties, to be under the control of the King ("*in manu sua*") ; and that private persons might enjoy it, "*sed de gratia ipsuis Regis speciali.*"

Y.B. 49 Edw. III, 3 (1375). A devised lands to B for life, remainder "*a deux des meliour homes de la Guild de la Fraternity de Whitawyers en Londres*" forever. A died without heirs, and on the death of B the king claimed the land by escheat. The court held that the devise (after B's life estate) was void. BELKNAP expressed his opinion that, even if the devise had been to "the Fraternity," it would not have been good, because the commonalty of London cannot by their own act create a community within the community without the charter of the king. A "Fraternity" is not a term known to the law, nor can a community exist without a charter. ("*Le commen de Londres ne poet my d'eux mesme faire comen deins cest comen sans chartr le Roy. . . . Fraternity n'est my terme de ley, ne comen ne puit my estre sans chre.*") KNYVET, Chancellor, with greater precision of thought, said that this commonalty of the gild, which is not confirmed by the king, could not be adjudged a body capable of taking an estate by purchase. ("*Il ne poet pas estre p. la ley q. c. cominalty de la Guilde, q. n'est affirme p. chre le Roy, purroit etre adjudgee un corps de purchace estate.*")

Y.B. 20 Edw. IV, 2 (1480). B, alderman of the X gild, brought debt against C, and counted upon an obligation made to A, sometime alderman of the gild, and his successors. Objection that the plaintiff had not shown how the corporation was formed. Littleton took a distinction between a "corporation of common right" and a gild. The judges were all of opinion that, if suit could be maintained, it would be by the executor of A. See also Y.B. 22 Edw. IV, 34.

In Y.B. 14 Hen. VIII, 2 (1522), Fineux remarked: "There is a corporation by the Pope alone, as those mendicant brothers who cannot purchase." But Brooke, writing after the Reformation, laid it down that if the Pope purports to create a corporation, "*ideo ceo est usurpation et voyd a cest jour et fuit imperpetuum.*" 1 Brooke, Abr. Corp. 33. See also Dyer, 81, pl. 64.

In *Terrett* v. *Taylor*, 9 Cranch, 43, STORY, J., said (p. 46): "At a very early period the religious establishment of England seems to have been adopted in the colony of Virginia; and, of course, the common law upon that subject, so far as it was applicable to the circumstances of that colony. The local division into parishes for ecclesiastical purposes can be very early traced; and the subsequent laws enacted for religious purposes evidently presuppose the existence of the Episcopal church with its general rights and authorities growing out of the common law. What those rights and authorities

are, need not be minutely stated. It is sufficient that, among other things, the church was capable of receiving endowments of land, and that the minister of the parish was, during his incumbency, seized of the freehold of its inheritable property, as emphatically *persona ecclesiae*, and capable, as a sole corporation, of transmitting that inheritance to his successors. The church wardens, also, were a corporate body clothed with authority and guardianship over the repairs of the church and its personal property; and the other temporal concerns of the parish were submitted to a vestry composed of persons selected for that purpose."

In *The Governor* v. *Allen*, 8 Humph. (Tenn.) 176, the court held that the governor of the State was, by force of the common law, a corporation sole.

In *People* v. *Mackey*, 255 Ill. 144, Mr. Justice VICKERS said (p. 156): "A private corporation is an organization for the benefit of its members. When brought into being it enjoys certain rights and privileges of great value that are not enjoyed by natural persons. The right to be a corporation is not a natural or a civil right of any person, and such right can only be acquired from the sovereign State. It is a matter exclusively within the power of the legislature to determine whether it will grant or withhold the privilege of forming corporations. If the legislature determines to exercise its discretion and grant the privilege it may prescribe the terms and conditions upon which the right is to be exercised."

This general statement by Mr. Justice VICKERS must, it is submitted, be qualified in so far as, but only in so far as, the ancient doctrine of corporations at the common law still has virility.

ST. 6 GEORGE I.

C. 18, §§ XVIII and XIX (1719).

XVIII. And whereas it is notorious, that several undertakings or projects of different kinds have, at some time or times since the four and twentieth day of June one thousand seven hundred and eighteen, been publicly contrived and practised, or attempted to be practised, within the city of London and other parts of this kingdom, as also in Ireland, and other his Majesty's dominions, which manifestly tend to the common grievance, prejudice, and inconvenience of great numbers of your Majesty's subjects in their trade or commerce, and other their affairs; and the persons who contrive or attempt such dangerous and mischievous undertakings or projects, under false pretences of public good, do presume, according to their own devices and schemes, to open books for public subscriptions, and draw in many unwary persons to subscribe therein towards raising great sums of money, whereupon the

subscribers or claimants under them do pay small proportions thereof, and such proportions in the whole do amount to very large sums; which dangerous and mischievous undertakings or projects do relate to several fisheries, and other affairs, wherein the trade, commerce, and welfare of your Majesty's subjects, or great numbers of them, are concerned or interested: and whereas in many cases the said undertakers or subscribers have, since the said four and twentieth day of June one thousand seven hundred and eighteen, presumed to act as if they were corporate bodies, and have pretended to make their shares in stock transferable or assignable, without any legal authority, either by act of parliament, or by any charter from the crown for so doing; and in some cases the undertakers or subscribers, since the said four and twentieth day of June one thousand seven hundred and eighteen, have acted or pretended to act under some charter or charters formerly granted by the crown for some particular or special purposes therein expressed, but have used or endeavored to use the same charters for raising joint stocks, and for making transfers or assignments, or pretended transfers or assignments for their own private lucre, which were never intended or designed by the same charters respectively; and in some cases the undertakers or subscribers, since the said four and twentieth day of June one thousand seven hundred and eighteen, have acted under some obsolete charter or charters, although the same became void or voidable by non-user or abuser, or for want of making lawful elections, which were necessary for the continuance thereof; and many other unwarrantable practices (too many to enumerate) have been, and daily are and may hereafter be contrived, set on foot, or proceeded upon, to the ruin and destruction of many of your Majesty's good subjects, if a timely remedy be not provided: and whereas it is become absolutely necessary, that all public undertakings and attempts, tending to the common grievance, prejudice, and inconvenience of your Majesty's subjects in general, or great numbers of them, in their trade, commerce, or other lawful affairs, be effectually suppressed and restrained for the future, by suitable and adequate punishments for that purpose to be ascertained and established: now for suppressing such mischievous and dangerous undertakings and attempts, and preventing the like for the future, may it please your most excellent Majesty, at the humble suit of the said lords spiritual and temporal and commons, in this present parliament assembled, that it may be enacted; and be it enacted by authority of this present parliament, that from and after the four and twentieth day of June one thousand seven hundred and twenty, all and every the undertakings and attempts described, as aforesaid, and all other public undertakings and attempts, tending to the common grievance, prejudice, and inconvenience of his Majesty's subjects, or great numbers of them, in their trade, commerce, or other lawful affairs, and all public subscrip-

tions, receipts, payments, assignments, transfers, pretended assignments and transfers, and all other matters and things, whatsoever, for furthering, countenancing or proceeding in any such undertaking or attempt, and more particularly the acting or presuming to act as a corporate body or bodies, the raising or pretending to raise transferable stock or stocks, the transferring or pretending to transfer or assign any share or shares in such stock or stocks, without legal authority, either by act of parliament, or by any charter from the crown, to warrant such acting as a body corporate, or to raise such transferable stock or stocks, or to transfer shares therein, and all acting or pretending to act under any charter, formerly granted from the crown, for particular or special purposes therein expressed, by persons who do or shall use or endeavor to use the same charters, for raising a capital stock, or for making transfers or assignments, or pretended transfers or assignments of such stock, not intended or designed by such charter to be raised or transferred, and all acting or pretending to act under any obsolete charter become void or voidable by non-user or abuser, or for want of making lawful elections, which were necessary to continue the corporation thereby intended, shall (as to all or any such acts, matters, and things, as shall be acted, done, attempted, endeavored, or proceeded upon, after the said four and twentieth day of June one thousand seven hundred and twenty) forever be deemed to be illegal and void, and shall not be practised or in any wise put in execution.

XIX. And be further enacted by the authority aforesaid, that from and after the said four and twentieth day of June one thousand seven hundred and twenty, all such unlawful undertakings and attempts, so tending to the common grievance, prejudice, and inconvenience of his Majesty's subjects, or a great number of them, in their trade, commerce, or other lawful affairs, and the making or taking of any subscriptions for that purpose, the receiving or paying of any money upon such subscriptions, the making or accepting of any assignment or transfer, or pretended assignment or transfer, of any share or shares upon any such subscription, and all and every other matter and thing whatsoever, for furthering, countenancing, or proceeding in any such unlawful undertaking or attempt, and more particularly the presuming or pretending to act as a corporate body, or to raise a transferable stock or stocks, or to make transfers or assignments of any share or shares therein, without such legal authority, as aforesaid, and all acting or pretending to act under any charter formerly granted from the crown for any particular or special purposes therein expressed, by persons making or endeavoring to make use of such charter for any such other purpose not thereby intended, and all acting or pretending to act under any such obsolete charter as is before described, and every of them (as to all or any such acts, matters or things as shall be so acted, done, attempted, en-

deavored or proceeded upon, after the said four and twentieth day of June one thousand seven hundred and twenty) shall be deemed to be a public nuisance, and nuisances, and the same, and all causes, matters, and things relating thereto, and every of them, shall forever hereafter be examined, heard, tried, and determined as common nuisances are to be examined, heard, tried, and determined by or according to the laws of this realm; and all offenders therein, being thereof lawfully convicted upon information or indictment, in any of his Majesty's courts of record at Westminster, or in Edinburgh, or in Dublin, shall be liable to such fines, penalties, and punishments, whereunto persons convicted for common and public nuisances are, by any of the laws and statutes of this realm, subject and liable; and moreover shall incur and sustain any further pains, penalties, and forfeitures, as were ordained and provided by the statute of provision and præmunire made in the sixteenth year of the reign of King Richard the Second.

NOTE. — This statute was repealed in 1825, 6 Geo. IV, c. 91.

In *Kinder* v. *Taylor*, L.J. Ch. (Old Series) vol. III, p. 68, decided in 1825, Lord ELDON, in speaking of this statute, said (p. 81) that the courts had not explained or defined what it was that constituted acting as a corporation; that the statute supposes, and he himself confidently believed, that to act as a corporation, not being a corporation, was an offense at common law; that in dealing with transactions of this kind it should never be forgotten that there is common law as well as a statute law; and that what may not be within the comprehension of the statute may, nevertheless, be within the prohibition of the common law.

In *Garrard* v. *Hardey*, 5 Man. & Gr. 471, TINDAL, C. J., said (p. 483): "The raising and transferring of stock in a company cannot be held, in itself, an offence at common law. . . . We find no authority for holding that an allegation that the parties raised and transferred stock is simply, and *per se*, without any statement of the mode by which it injures or defrauds the public, an indictable offence at common law." See, *accord*, *Harrison* v. *Heathorn*, 6 Man. & Gr. 81, 140; *Re The Mexican & South American Co.*, 27 Beav. 474, 480.

This statute has, it is submitted, never been in force in any jurisdiction in the United States, although it was not repealed until after the Revolution. See *Phillips* v. *Blatchford*, 137 Mass. 510.

The legal possibility and consequences of corporate action, unauthorized by the State, are considered below in the Book on "Unauthorized Corporate Action."

B. Grant of Authority from the State.

FRANKLIN BRIDGE CO. *v.* WOOD.

14 Ga. 80. 1853.

Assumpsit in Heard Superior Court. Tried before Judge Hill, May Term, 1853.

The Franklin Bridge Company was incorporated under the Act of the Legislature of 1843, to prescribe the mode of incorporating companies for certain purposes, by an order of the Inferior Court of Heard County.

The company sued the defendant, Wood, for his subscription to their stock.

The defendant pleaded that the company was not legally incorporated; contending that the act of the legislature, referred to, was unconstitutional and void.

Upon argument, the court held that the act aforesaid, was unconstitutional, and non-suited the plaintiffs.

To this decision plaintiff excepted.

By the Court. — Lumpkin, J., delivering the opinion.

Is the act of 1843, and that of 1845, amendatory thereof, pointing out the manner of creating certain corporations and defining their rights, privileges and liabilities, unconstitutional?

By the first section of the act of 1843, it is provided "That when the persons interested, shall desire to have any church, camp ground, manufacturing company, trading company, ice company, fire company, theatre company, or hotel company, bridge company, and ferry company, incorporated, they shall petition in writing the Superior or Inferior Court of the county where such association may have been formed, or may desire to transact business for that purpose, setting forth the object of their association, and the privilege they desire to exercise, together with the name and style by which they desire to be incorporated; and said court *shall pass a rule or order*, directing said petition to be entered of record on the minutes of said court."

Section 2 enacts "That when such rule or order is passed, and said petition is entered of record, the said companies or associations shall have power respectively, under and by the name designated in their petition, to have and use a common seal; to contract, and be contracted with; to sue, and be sued; to answer, and be answered unto in any court of law, or equity; to appoint such officers as they may deem necessary; and to make such rules and regulations as they may think proper for their own government: not contrary to the laws of

this State: but shall make no contracts, or purchase, or hold any property of any kind, except such as may be absolutely necessary to carry into effect the object of their incorporation. Nothing herein contained shall be so construed as to confer banking or insurance privileges on any company or association herein enumerated; and the individual members of such manufacturing, trading, theatre, ice, and hotel companies, shall be bound for the punctual payment of all the contracts of said companies, as in case of partnership."

By the act of 1845, the provisions of the act of 1843 are extended to all associations and companies whatever, except Banks and Insurance companies: and the individual members of all such incorporations are made personally liable for all the contracts of said associations or companies. (*Ibid.*)

The argument against the validity of the charter of the Franklin Bridge Company, created under these statutes, is this:

[1.] That in England, corporations are created and exist by prescription; by royal charter; and by Act of Parliament. — With us, they are created by authority of the legislature, *and not otherwise.* That to establish a corporation, is to enact a law; and that no power but the legislative body can do this.

[2.] That legislative power is vested, under our constitution, in the General Assembly, to consist of a Senate and House of Representatives, to be elected at stated periods, by the citizens of the respective counties.

[3.] And that the General Assembly is bound to exercise the power of making laws, thus conferred upon them, by the people, in the primordial compact, in the mode therein prescribed, and in none other; and that a law made in any other mode is unconstitutional and void. That the legislature is but the agent of their constituents; and that they cannot transfer authority delegated to them to any other body, corporate or otherwise — not even to the judiciary, a coördinate department of the government, unless expressly empowered by the constitution to do so. That to do this, would be to violate one of the fundamental maxims of jurisprudence, as well as of political science, namely: *delegata potestas, non potest delegari.* That to do this, would not only be to disregard the constitutional inhibition, which is binding upon the representative, but by shifting responsibility, introduce innovations upon our system, which would result in the overthrow and ultimate destruction of our political fabric.

The constitutional inquiry thus presented is an exceedingly grave one. It reaches far beyond the case made in the bill of exceptions, and extends to the whole range of topics which fall under legislative cognizance. In the view we take, however, of the statutes before us, no such proposition as that which has been discussed, is presented for our adjudication. And we rejoice that it is so — not only on account of the delicacy of the task, in pronouncing an act of the legis-

lature unconstitutional and void; one which is never justifiable, unless the case is clear and free from doubt; and even then, one might almost be forgiven for shrinking from the performance of a duty, which would be productive of such incalculable mischief and confusion. Bridges have been built at a heavy expense; manufacturing and innumerable other associations, have been formed in Georgia, and are in full operation, under charters incorporated under this law. And in view of the consequences, any court might hesitate, unless the repugnance between the statute and the constitution was so palpable as to admit of no doubt, and produce a settled conviction of their incompatibility with each other.

[4.] It was formerly asserted, that in England, the act of incorporation must be the *immediate* act of the king himself, and that he could not grant a license to another, to create a corporation. (10 Reports, 27.) But Messrs. Angell and Ames, in their treatise on corporations, state that the law has since been settled to the contrary; and that the king may not only grant a license to a subject to erect a particular corporation; but give a general power, by charter, to erect corporations indefinitely; on the principle that *qui facit per alium, facit per se;* that the persons to whom the power is delegated, of establishing corporations, are only an instrument in the hands of the Government. (1 Kyd 50; 1 Black. Comm. Ang. & Am. 63.)

Before the Revolution, charters of incorporation were granted by the proprietaries of Pennsylvania, under a derivative authority from the Crown; and those charters have since been recognized as valid. (3 Wilson's Lectures, 409.) A similar power has been delegated by the legislature of Pennsylvania, with regard to churches. (7 S. & R. 517.) The acts of the instrument in these cases, become the acts of the mover, under the familiar maxim above mentioned. (See also 1 Missouri R. 5.)

[5.] Our opinion is, that no legislative power is delegated to the courts by the acts under consideration. There is simply a ministerial act to be performed — no discretion is given to the courts. The duty of passing the rule or order, directing the petition of the corporators to be entered of record on the minutes of the court, setting forth to the public the object of the association, and the privilege they desire to exercise, together with the name and style by which they are to be called and known, is made *obligatory* upon the courts; and should they refuse to discharge it, a mandamus would lie to coerce them. It is true, the legislature has seen fit to use the courts for the purpose of giving legal form to these companies. But it might have been done in any other way. Under the free banking law of 1838, instead of petitioning the court, and having the order passed and entered upon its minutes, the certificate, specifying the name of the association; its place of doing business; the amount of its capital stock; the names and residence of the shareholders; and the time for which the com-

pany was organized, is required merely to be proven, and acknowledged, and recorded in the office of the clerk of the Superior Court, where any office of the association is established, and a copy filed with the comptroller-general. (Cobb's Digest, 107, 8.)

And so under the act of 1847, authorizing the citizens of this State, and such others as they may associate with them, to prosecute the business of manufacturing, with corporate powers and privileges. The persons who propose to embark in that branch of business are required to draw up a declaration, specifying the objects of their association, and the particular branch of business they intend carrying on, together with the name by which they will be known as a corporation, and the amount of capital to be employed by them; which declaration is required to be first recorded in the clerk's office of the Superior Court of the county where such corporation is located, and published once a week for two months in the two nearest gazettes: which being done, it is declared that said association shall become a body corporate and politic, and known as such, without being specially pleaded in all courts of law and equity in this State; to be governed by the provisions, and be subject to the liabilities therein specified. (Cobb's Digest, 439, 440.)

In these two instances, and others which might be cited, the legislature have dispensed with the action of the courts, or of any other agency to carry out their enactments, with regard to these various associations; which have become the usual and favorite mode of conducting the industrial pursuits of the civilized world in modern times.

All these statutes were complete as laws when they came from the hands of the legislature; and did not depend for their force and efficacy upon the action or will of any other power. It is true that they could only take effect upon the happening of some event, such as the filing the petition or declaration, and giving publicity to the purpose of the association, in the mode prescribed by the act. But if this were a good reason for regarding these statutes as invalid, then how few corporations could abide the test. For it requires the *acceptance* of the charter, to create a corporate body; for the Government cannot compel persons to become an incorporated body, without their consent. And this consent, either express or implied, is generally subsequent, in point of time, to the creation of the charter. And yet, no charter that we are aware of, has been adjudged invalid, because the law creating it and previously defining its powers, rights, capacities and liabilities, did not take effect until the acceptance of the corporate body, or at least a majority of them was signified.

The result, therefore, of our deliberation upon this case is, that the acts of 1843 and 1845, vesting in all associations, except for banking and insurance, the power of self-incorporation, do not impugn the constitution; and that the charter of the Franklin Bridge Com-

pany, and all others, created under them, and in conformity to their provisions, are legal and valid. With the policy of these statutes, we have nothing to do. The province of this, and all other courts, is *jus dicere*, not *jus dare*.

Judgment reversed.

NOTE. — *Matter of N. Y. Elevated R. R. Co.*, 70 N. Y. 327. The legislature authorized certain commissioners to determine whether elevated and underground railroads were necessary, and, if any particular proposed railroad was found to be necessary, to fix the route, prescribe the plan of construction, and fix the amount of capital stock of the corporation to be formed for the purpose of building such railroad. The court held this act to be constitutional. EARL, J., said (p. 343): "It is objected that the act is unconstitutional, because it delegates legislative power to the mayor's commissioners. . . . The act rests upon the legislative will, and in no way depends for its vitality upon the action of the commissioners. Corporations organized under the act derive their franchises from the legislature, and in no proper sense from the commissioners. The commissioners perform no legislative acts; they enact no laws; they simply perform administrative acts in carrying the law into effect and applying it. The legislature is required by the Constitution to pass general laws for the formation of corporations (art. 3, § 18; art. 8), and it has passed general laws for the formation of all kinds of corporations. In such cases, it does not directly confer corporate franchises; it simply provides the mode in which such franchises may be acquired by those desiring them. Ordinarily, individuals desiring to incorporate under a general law determine for themselves the necessity of a corporation, their corporate name, what business they will carry on, where they will transact it, the amount of their capital and the duration of their corporation. In making such determinations, it was never supposed that they were engaged in acts of legislation, or that they conferred upon themselves corporate franchises. They simply act under, apply and carry into effect a law in reference to which legislative power has been properly evoked. But suppose, instead of leaving the determination of these matters to individuals, the law provides a tribunal to make the determination for the individuals, is there any more delegation of legislative power to the tribunal than to the individuals, under the general laws as they are now usually framed? Cannot the legislature confer upon a commission the power, upon the application of individuals, to make the same determination for the individuals which they could make for themselves? The proper answers to these questions are not doubtful. The arguments made to show that the legislature was not competent to devolve upon these commissioners the powers given to them in this act, if sound and logically applied, would nullify every general law

found upon our statute books for the formation of corporations, and thus nullify the Constitution itself, which commands the passage of such general laws."

See also *Granby Mining Co.* v. *Richards*, 95 Mo. 106, 112. But cf. *State* v. *Armstrong*, 3 Sneed (Tenn.) 634, 652.

PENOBSCOT BOOM CORPORATION *v.* LAMSON.

16 Me. 224. 1839.

CHAPTER 236 of the Special and Private Acts for 1832, passed by the legislature of Maine, provided: "Rufus Dwinal, his associates and successors, be and hereby are constituted a body corporate, by the name of the Penobscot Boom Corporation, and shall so continue for the term of thirty years — and by that name may sue and be sued; have a common seal, make by-laws not repugnant to the laws of this State for the management of their corporate concerns, and have and enjoy all the rights and powers of similar corporations." Permission to erect a boom across the Penobscot River was given to such corporation.

A suit was brought in the name of the Penobscot Boom Corporation for boomage of logs, asserted to belong to the defendants. The defendants denied there was such a corporation, alleging there had been no organization under the said act, and no officers elected.

SHEPLEY, J. The existence of such a corporate body is denied, and it is said that it does not come within the legal description of a corporation, either sole or aggregate, as defined by any code of laws. Corporations originating according to the rules of the common law, must be governed by it in their mode of organization, in the manner of exercising their powers, and in the use of the capacities conferred. And when one claims its origin from such a source, its rules must be regarded in deciding upon its legal existence. The legislature may however create a corporation, not only without conforming to such rules, but in disregard of them; and when a corporation is thus created, its existence, powers, capacities, and the mode of exercising them, must depend upon the law of its creation. It was the pleasure of the legislature in this case to create a corporate body, without requiring a conformity to the usual mode of organization known to the law. The grant is to one person, who was at liberty to associate others, or to have a succession without it. No provision is made for a division of the property allowed to be held into shares, or for the call of any meeting, or the choice of a clerk, or any other officer, or the keeping of any records, or any mode of organization. And yet many important powers and privileges are granted with an evident design to permit their exercise. The grant being to one person and without

any such provisions, the inference necessarily is, that it was the intention of the legislature to permit that one person or his successor to exercise all the corporate powers, and to make his acts, when acting upon the subject matter of the corporation and within its sphere of action and grant of power, the acts of the corporation. There does not appear to be any other mode of carrying into effect the intention of the legislature.

STATE *v.* DAWSON.

16 Ind. 40. 1861.

APPEAL from the Clark Circuit Court.

PERKINS, J. Information against the defendants, charging that they are pretending to be a corporation, and to act as such, when they are not a corporation. It charges that in January, 1849, the legislature of the State of Indiana enacted a special charter of incorporation (which is set out at length) for a railroad from Fort Wayne, Indiana, to Jeffersonville, to be called the Fort Wayne and Southern Railroad; that the persons named in the charter as directors did not accept said charter till June 2, 1852, when they did meet and accept the same, and organize under it. It is alleged that the defendants are assuming to act under said charter, never having organized under any other. The court below sustained a demurrer to the information: thus holding the defendants to be a legal corporation.

The present constitution of Indiana took effect on November 1, 1851. It contains these provisions: —

"All laws now in force and not inconsistent with this constitution, shall remain in force, until they shall expire or be repealed." Sched. (1 sub. sec.) of Const.

"Corporations, other than banking, shall not be created by special act, but may be formed under general laws." Art. 11, sec. 13.

"All acts of incorporation for municipal purposes shall continue in force under this constitution, until such time as the General Assembly shall, in its discretion, modify or repeal the same." Sched. *supra*, sub. sec. 4.

The charter for the Fort Wayne and Southern Railroad was not a charter for municipal purposes, and, hence, was not specially continued in existence. Art. 11, sec. 13, above quoted, prohibits the creation of a corporation by special act or charter, that is, as we construe the prohibition, through, or by virtue of, such special act or charter, after November 1, 1851. The policy that induced the prohibition, as well as its literal import, demands this construction. It is necessary for us to ascertain, then, when the defendants, if ever, were created a corporation. The simple enactment of the charter for the corporation, by the legislature, did not create the corporation.

It required one act on the part of the persons named in the charter to do that, viz.: acceptance of the charter enacted.

Says Grant, in his work on Corporations (*vide* p. 13): "Nor can a charter be forced on any body of persons who do not choose to accept it." And again, at page 18, he says, "The fundamental rule is this: no charter of incorporation is of any effect until it is accepted by a majority of the grantees, or persons who are to be the corporators under it. *Bagge's case*, 2 Brownl. & G. 100; s. c. 1 Roll. Rep. 224; *Dr. Askew's case*, 4 Burr. 2200; *Rutter* v. *Chapman*, 8 M. & W. 25; per WILMOT, J., *Rex* v. *Vice-Chancellor of Cambridge*, 3 Burr. 1661. This is analogous to the general rule that a man can not be obliged to accept the grant or devise of an estate. *Townson* v. *Tickell*, 3 B. & Ald. 31." See, also, Ang. & Am. sec. 83, where it is said, if a charter is granted to those who did not apply for it, the grant is said to be *in fieri* till acceptance. We need not inquire whether this rule extends to municipal corporations in this country. As to what may constitute an acceptance we are not here called on to decide, as the information expressly shows that there was none in this case till June, 1852, which fact is admitted by the demurrer.

The grant of the charter in question, then, to those who had not applied for it, was but an offer, on the part of the State; a consent that the persons named in the charter might become a corporation, might be created such an artificial being, by accepting the charter offered. But an offer, till accepted, may be withdrawn. In this case, the offer made by the State, in 1849, was withdrawn by the State, November 1, 1851, by then declaring that no corporation, after that date, should be created except pursuant to regulations which she, in future, through her legislature would prescribe.

This pretended corporation, then, was not created before November 1, 1851; and it could be created afterward only by the concurrent consent of the State and the corporators. But, at that date, the constitution prohibited both the State and corporators from giving consent to such a corporation, to wit: one coming into existence through a special charter; and hence necessarily prohibited the creation thereof. This decision accords with that of the Supreme Court of the United States in *Aspinwall* v. *Daviess County*, 22 How., p. 364; where it was held that the new constitution prohibited a subscription of stock to the Ohio and Mississippi Railroad Company, authorized by the charter of the corporation, granted under the former constitution, and actually voted by the people of the county, under that constitution.

Whether, as a matter of fact, the charter in this case was accepted under the old constitution, must be determined on a trial of the cause below.

Had the provision in our constitution, like that on this subject in the Constitution of Ohio, ordained that the legislature should "pass

no special act conferring corporate powers," the restraint would clearly have been imposed alone upon future legislative action; but, in our constitution, the restraint is plainly imposed upon the creation, the organization, of the corporation itself. See *The State* v. *Roosa*, 11 O. St. R. 16.

Per Curiam. — The judgment is reversed, with costs. Cause remanded for further proceedings in accordance with this opinion.

ELLIS *v.* MARSHALL

2 Mass. 269. 1807.

Ejectment. The plaintiff claimed under a sale by the "Front Street Corporation in the town of Boston," established by a law of the Commonwealth, passed March 6, 1804. 3 Mass. Special Laws, 375. By this statute sundry persons, and amongst them the defendant, Marshall, described as "being owners and proprietors of the lands and flats over which the said street will pass, and of the lands and flats adjoining thereto," are incorporated for the purpose of making a street in the town of Boston. By the third section of the statute, the corporation are authorised to assess upon all the owners and proprietors of said land and flats, according to the proportion they severally hold therein, such sums of money as shall be agreed upon by the said proprietors, or the major part of such of them as shall be assembled at any legal meeting to be called for that purpose; and if any of the said proprietors shall neglect or refuse to pay the sums of money duly assessed upon him therefor, for the space of three months, the proprietors are authorised to sell, at public auction, so much of such delinquents share of said lands and flats as shall be sufficient to pay the sums so assessed, and the charges of sale: and the said proprietors may, by their clerk or committee, execute a good deed to the purchaser in fee simple.

At the last March term the parties agreed on the following state of facts, viz.

"That the act, creating the Front Street Corporation, was passed in consequence of the petition to the General Court, of the major part in number and interest of the owners of the land over and adjoining to which the said Front Street is built, but that the said Marshall, who was one of the said owners, did not subscribe the said petition.

"That a committee of the General Court, to whom the said petition was duly referred, to hear all persons interested, and to report, after giving public and general notice to all persons, heard such persons as appeared, and reported that the said petition be granted, pursuant whereto, the said act was passed; but that the said Mar-

shall did not appear before the committee, nor by word or in writing assent to the said petition, or to the passing of the said act.

"That there is no other William Marshall, proprietor of lands and flats, adjoining said street, but the defendant, and none other known to the parties, to whom the said act can apply; and that the Court shall consider the defendant and William Marshall, named in the said act, as the same person, if the facts before agreed to should, in the opinion of the court, be sufficient for a jury so to find.

"That, after the said act passed, the said Marshall was regularly notified to attend at all the meetings of the said corporation, but did not attend at any of them; and that the said Marshall's land adjoining said Front Street is benefited by the said street in the same proportion, as the other lands adjoining the said street are benefited.

"That on the twelfth day of May, A.D. 1804, being after the said street was begun to be built, and before it was finished, the said Marshall was requested by the said proprietors to join them in a covenant, wherein they mutually agreed not to erect any buildings within ten feet of the western side of said street, which he refused; but, as a substitute, a separate instrument was signed by him for that purpose, which contains the following provision, 'Provided however, that this instrument, or any thing herein contained shall not be considered as binding the said William Marshall to pay any part of the expence of making the road aforesaid, but the legal rights and remedies of all parties concerned in that respect shall remain the same as if this instrument had not been made.'

"That on the tenth day of October last the land demanded in this action, being part of said Marshall's estate adjoining said street, was sold at public auction, according to the rules and regulations of the Corporation, and the powers granted in said act, for the purpose of raising the amount of the assessment taxed on him by said Corporation, as being towards his proportionate part of the expence of making said street, which, though often requested, he had refused to pay, and a deed of conveyance thereof was accordingly given by said Corporation to said Ellis, to hold the premises demanded, to him in fee simple.

"If on the foregoing facts the court should be of opinion that the said Corporation could, by virtue of the said act, legally assess the said Marshall, and sell his lands for non-payment thereof, then it was agreed that the defendant should be defaulted, and judgment should be rendered for the plaintiff; otherwise the plaintiff was to become nonsuit, and judgment be rendered for the defendant. And it was further agreed that, if any facts contained in the above statement could not by law be given in evidence to a jury in the trial of the cause, then such facts are to be considered as no part of the statement."

Parker, J., after a brief recapitulation of the facts in the cause, delivered the opinion of the court as follows.

From the foregoing facts and the arguments thereon by the counsel, it appears that all the proceedings of the corporation relative to the assessment and sale were correct; so that if Marshall were, at the time thereof, a member of the corporation, the title to the demanded premises in Ellis could not be disputed.

We are therefore necessarily brought to the question, indeed the only one in the case, whether Marshall, by virtue of the act aforesaid, became a member of the said corporation, subject to its rules and regulations, and liable to be assessed for the purpose of building said street.

The counsel for the plaintiff have contended.

1st. That by virtue of the act itself, Marshall being named therein, he became *ipso facto* a member of the corporation, the legislature having competent power to compel him thereto:

2dly. That should this not be the case, the foregoing facts contain sufficient evidence of his consent, tacit at least, to the passing of said act, and the insertion of his name therein.

The determination of the first point requires that we should ascertain the true nature and character of this legislative proceeding. If it were a public act, predicated upon a view to the general good, the question would be more difficult. If it be a private act, obtained at the solicitation of individuals, for their private emolument, or for the improvement of their estates, it must be construed, as to its effect and operation, like a grant. We are all of opinion that this was a grant or charter to the individuals who prayed for it, and those who should associate with them; and all incorporations to make turnpikes, canals, and bridges must be so considered.

Can then one, whose name is by mistake or misrepresentation inserted in such an act, refuse the privileges it confers, and avoid the burthens it imposes? If he cannot, then the legislature may, at all times, press into the service of such corporations those whose lands may be wanted for such objects, whenever they may be prevailed on to insert the names of such persons, by the intrigue or mistake of those more interested in the success of the object. No apprehension exists in the community that the legislature has such power. That the land of any person, over or through which a turnpike or canal may pass, may be taken for that purpose, if the legislature deem it proper, is not doubted. The constitution gives power to do this, provided compensation is made. But it was never before known, that they have power over the person, to make him a member of a corporation, and subject him to taxation, *nolens volens*, for the promotion of a private enterprize.

That a man may refuse a grant, whether from the government or an individual, seems to be a principle too clear to require the sup-

port of authorities. That he may decline to improve his land, no one will doubt. Although the legislature may wisely determine that a certain use of his property will be highly beneficial to him, he has a right to judge for himself on points of this nature. The fact therefore in the case, that Marshall is benefited equally with the other owners by the making of this street, is of no importance. In *Bagg's case*, Roll's Rep. 224, it seems to be agreed by the court, that a patent procured by some persons of a corporation shall not bind the rest, unless they assent. And in Brownlow's Reports, 100, there is this passage, "It was said that inhabitants of a town cannot be incorporated without the consent of the major part of them, and an incorporation without their consent is void."

In Comberbach, 316, HOLT, speaking of a new charter made to the city of Norwich, by Henry IV, and confirmed by Charles II, says, the new charter had been void, if the corporation had refused it, but when they accept it, and put it in execution, it is good.

If these principles were correct in England in times when prerogative ran high, and the crown or the parliament could not force charters or patents upon the subject without his assent, surely in this free country, where the legislature derives its power from the people, such authority cannot be contended for.

Plaintiff Nonsuit.

NOTE. — See, *accord*, *Askew's Case*, 4 Burr. 2186, 2199.

MIDDLESEX HUSBANDMEN *v.* DAVIS.

3 Met. (Mass.) 133. 1841.

ASSUMPSIT on a promissory note.

WILDE, J. The first [objection] is, that there is no sufficient evidence of the plaintiffs' acceptance of their act or charter of incorporation, granted in 1803, or of their legal organization according to the provision of that act, or of their acceptance of the additional act of 1819, c. 73.

It is true that it does not appear by the records of the society that the act of incorporation has been accepted by an express vote to that effect; nor does it appear in what manner the first meeting of the corporation was called: But the presumptive proof, both of the acceptance of the act of incorporation, and of the legal organization of the society, is exceedingly strong, and quite as satisfactory as direct evidence. That such presumptive evidence is admissible and proper is fully maintained by the decisions in *Dedham Bank* v. *Chickering*, 3 Pick. 335, and in *Bank of United States* v. *Dandridge*, 12 Wheat. 71, and by the numerous authorities cited in the latter case. By these

authorities it is now well settled, whatever may have been the ancient doctrine as to corporations, that as the acts of private persons, even of the most solemn nature, may be presumed, or proved by presumptive evidence; so as to the acts of a corporation, if they cannot be reasonably accounted for but on the supposition of other acts done to make them legally operative and binding, they are presumptive proofs of such other acts. Thus, as deeds and grants to private persons, which are beneficial to them, are presumed to have been accepted, so also may the acceptance of an act or charter of incorporation, beneficial to the corporation, be presumed, for the like reason. And a long lapse of time, and the continued exercise of the corporate powers granted to a corporation, sufficiently justify the presumption of the acceptance of the charter. So if a particular charter is applied for, and it is granted, the acceptance may be presumed from such previous application. All these grounds of presumption seem to concur in the present case; and we think, therefore, that the presumptive proofs of the acceptance of the act of incorporation, and the organization of the society, are full and satisfactory.

NOTE. — The subject of the formation of corporations by special acts is to-day of diminished importance. Except in about half a dozen States, there are important constitutional limitations on the power of the legislature to form corporations by special act.

REED *v.* THE RICHMOND STREET R.R. CO.

50 Ind. 342. 1875.

DOWNEY, J. This was an action by the appellee against the appellant, to recover the amount of a subscription to the capital stock of the company. The subscription was made to an instrument purporting to be articles of association, and containing also an agreement to pay for the shares subscribed.

By a demurrer to the complaint, and also to the answer, the question is presented as to the proper construction of the following section of the act relating to the incorporation of street railway companies: —

"That any number of persons, not less than five, being subscribers to the stock of any contemplated street or horse railroad company, may be formed into a corporation for the purpose of constructing, owning, and maintaining street or horse railroads, switches, or side-tracks, upon or through the streets of the cities or towns within the State, by complying with the following requirements: Whenever stock to the amount of at least ten thousand dollars shall

have been subscribed, the subscribers to such stock shall elect directors for such company from their own number, and shall severally subscribe articles of association in which shall be set forth the name of the corporation, the amount of capital stock of the company, the number of shares of which said stock shall consist, the number of directors, and the names to manage the affairs of the company, the city or town in which it is proposed to construct such road." 3 Ind. Stat. 422, sec. 1.

The subscription having been made before the organization of the company, it was necessary to a recovery thereon that it should appear that the subsequent steps essential to bring the corporation into existence were duly taken. There was no corporation to which the benefits of the subscription could enure until such steps had been taken. *The Indianapolis, etc., Co.* v. *Herkimer*, 46 Ind. 142, and cases cited, and *Nelson* v. *Blakey*, 47 Ind. 3.

The complaint alleges, "that after ten thousand dollars or more of such stock had been subscribed," etc., "on," etc., "a large number, to wit, twelve, of the said subscribers met at the said city for the purpose of organizing and electing directors for said company, notice in writing of the time, place, and purpose of such meeting having been given by two of said subscribers through the post-office of said city to the defendant and the other subscribers, pursuant to article No. 4 of said articles of association, and the defendant being also personally notified of the time, place, and purpose of such meeting; and being so met and assembled, the said subscribers and stockholders proceeded to organize said company, and then and there adopted the said articles of association, and then and there elected seven of their number, to wit," etc., "as their directors to manage the affairs of said company, and thereupon the said association became and was a corporation, under the name and style aforesaid, for the purpose aforesaid."

Counsel for the appellant contend that under the section of the statute which we have set forth, it was necessary that articles of association should have been signed by the subscribers, in addition to the instrument which they had previously signed; while counsel for the appellee insist that the subscribers having already executed the articles, when they adopted them at the meeting of the stockholders, this was all that was necessary to comply with the statute.

Counsel for the appellee refer us to *Eakright* v. *The Logansport, etc., R.R. Co.*, 13 Ind. 404, as a case in point to sustain their views. There is, we think, an important difference between that case and the one under consideration. There, as the court say in the opinion, "all the requirements of the statute have, in this instance, been literally pursued, save that of naming the directors in the articles of association, and that, it seems to us, has, in effect, been done by the adoption of the articles when the directors were elected."

In the case under consideration, all that is said in the instrument in question about the directors is this: —

"Art. 3. The affairs, government, and control of said corporation shall be under the management of a board of directors, said board to consist of not less than five nor more than seven stockholders."

Not only is there a failure to name the directors in the articles of association, but, also, there is a failure to fix the number.

The statute under which this company attempted to organize, which we have already set forth in this opinion, requires the following things to be done by the subscribers after the requisite amount of stock has been subscribed: —

1. They shall elect directors from their own number.

2. They shall severally subscribe articles of association, in which shall be set forth: 1. The name of the corporation; 2. The amount of the capital stock of the company; 3. The number of shares of which said stock shall consist; 4. The number of directors to manage the affairs of the company, and their names; 5. The city or town in which it is proposed to construct such road.

Conceding that the statute has been complied with in other respects, it seems to us that there has been an entire failure to comply with the fourth requirement. If one of these requirements can be dispensed with, or held to be directory merely, we do not see where we are to stop. The case of *Eakright* v. *The Logansport, etc., R.R. Co., supra*, went as far in this direction as we are willing to go. The appellant never, in any way, assented to the number or names of the directors, for they were not stated in the articles signed by him, and he was not at the meeting when the number of directors was designated, and they were elected.

In our opinion, the court committed an error in ruling this point against the appellant.

The judgment is reversed, with costs, and the cause remanded, with instructions to sustain the demurrer to the complaint.

NOTE. — Subscriptions to the stock may be made a condition precedent to incorporation, but, if not, a corporation may have legal existence before it has stockholders. See *Coyotte Co.* v. *Rutle*, 8 Or. 284, 292. In *Dancy* v. *Clark*, 24 App. Cas. D.C. 487, 506, the court said that persons who executed the certificate of incorporation (which did not contain any subscriptions to stock) were "stockholders." *Sed qu.*

A corporation may be formed in one jurisdiction and transact its first business in another jurisdiction. *Hanna* v. *International Petroleum Co.*, 23 Ohio St. 622.

PEOPLE *v.* STOCKTON R.R. CO.

45 Cal. 306. 1873.

Appeal from the District Court of the Fifth Judicial District, County of San Joaquin.

This was an information filed by the Attorney General. The complaint averred that the "defendants had associated themselves together under the name of the Stockton and Visalia Railroad Company, unlawfully claiming to be a corporation, and by the name aforesaid are unlawfully acting as such pretended corporation, and have without right or authority usurped the franchise and privilege of a corporation." The complaint then stated the particulars wherein the defendant had failed to comply with the laws in relation to the formation of railroad corporations, which are the same mentioned in the opinion. Judgment of ouster was prayed for. The corporation was the only defendant.

The plaintiff had judgment in the Court below, and the defendant appealed.

Crockett, J. Section two of the Act of May 20th, 1861 (Stats. 1861, p. 607), provides that there shall be annexed to the articles of incorporation an affidavit "setting forth in substance that said amount of stock has been subscribed, and that ten per cent in cash thereon has been actually and in good faith paid in as aforesaid."

In this case the affidavit conforms strictly to the requirements of the statute, in stating that the ten per cent "in cash has been actually paid in," but omits the words "in good faith."

In the body of the certificate, however, it is stated that more than ten per cent of the amount subscribed "has been actually, in good faith, paid thereon," in cash; and the certificate, together with the affidavit, are in all respects regular, except, as already stated, the latter omits the words "in good faith." But we think this was a substantial compliance with the statute, which is all that was necessary.

Note. — See, *accord*, *Ex parte Spring Valley Water Works*, 17 Cal. 132 (failure to describe the place of business of the corporation "as the principal place of business"); *People* v. *Cheeseman*, 7 Col. 376 (notary public failed to certify that the parties acknowledging the articles were personally known to him); *Van Pelt* v. *Home Building Association*, 79 Ga. 439 (statement of purposes gathered from all the papers); *Thornton* v. *Balcolm*, 85 Iowa, 198; *Hughes* v. *Antietam Co.*, 34 Md. 316 (number of shares deduced from statements); *Buffalo Co.* v. *Hatch*, 20 N.Y. 157 (payment in good faith to directors inferred from statements); *Carpenter* v. *Frazier*, 102 Tenn. 462 (a scroll accepted as facsimile of a seal); *Rogers* v. *Danby Society*, 19

Vt. 187 (intent to form a corporate body gathered from statements). In *Eakright* v. *Logansport Co.*, 13 Ind. 404, directors were elected, but their names were not inserted in the articles. There is a dictum that, on all the facts, there was a substantial compliance with the statutory provisions. *Sed qu.* Cf. *Reed* v. *The Richmond Street R.R. Co.*, 50 Ind. 342, *supra.*

BUTLER PAPER CO. *v.* CLEVELAND.

220 Ill. 128. 1906.

MR. JUSTICE SCOTT. This suit was brought in the superior court of Cook County by the J. W. Butler Paper Company against Frederick W. Chamberlain, Harold I. Cleveland, and Harriet F. Cleveland to recover the sum of $1305.80 alleged to be due the plaintiff for merchandise sold by it to the defendants as officers and directors of the C. & C. Company, a corporation organized under the statute of this State.

The only question arising upon the record in the case, which is presented by certain propositions of law offered by the plaintiff below and refused by the court, is whether there was such a failure to comply with the provisions of "An act concerning corporations" (approved April 18, 1872, in force July 1, 1872), in organizing the C. & C. Company, of which the defendants were officers and directors at the time the merchandise was sold by the plaintiff to the C. & C. Company, as to render the defendants individually liable to the plaintiff therefor under section 18 of chapter 32, Hurd's Revised Statutes of 1903. That section, which was construed by this court in *Loverin* v. *McLaughlin*, 161 Ill. 417, reads as follows: —

"If any person or persons being, or pretending to be, an officer or agent, or board of directors, of any stock corporation, or pretended stock corporation, shall assume to exercise corporate powers, or use the name of any such corporation, or pretended corporation, without complying with the provisions of this act, before all stock named in the articles of incorporation shall be subscribed in good faith, then they shall be jointly and severally liable for all debts and liabilities made by them, and contracted in the name of such corporation, or pretended corporation."

The sole ground relied upon by the plaintiff as showing a defective incorporation of the C. & C. Company is the fact that the meeting of the subscribers to the capital stock of the company, held for the purpose of electing directors and for the transaction of such other business as might come before them, was not called in the manner pointed out by the statute.

Section 3 of chapter 32, *supra*, provides that notice of such meet-

ing shall be given "by depositing in the post-office, properly addressed to each subscriber, at least ten days before the time fixed, a written or printed notice, stating the object, time and place of such meeting."

Frederick W. Chamberlain, Harold I. Cleveland and Harriet F. Cleveland were the only subscribers to the capital stock of the C. & C. Company. The license to open books of subscription to the capital stock of the company was issued on December 10, 1902. On December 12, 1902, the three subscribers above named executed a written instrument by which they waived the notice provided for by section 3, *supra*, and requested the commissioners to convene the meeting at twelve o'clock, noon, of that day at room 913 Monadnock Block, in the city of Chicago, for the purpose of electing directors and the transaction of such other business as might come before them. Prior to the meeting, in pursuance of this written instrument, a notice was personally delivered to each of the three subscribers, notifying them of the object, time and place of the meeting. The subscribers met at the time and place specified and elected a board of directors, consisting of themselves and George A. Miller, who was one of the commissioners to whom the license had been issued by the Secretary of State.

A decision of this case depends upon the question whether the C. & C. Company is a corporation *de jure*. Proof of a corporation *de facto* does not relieve the directors and officers of the corporation from the liability imposed by section 18, *supra*. There must be a corporation *de jure* in order to escape that liability. *Loverin* v. *McLaughlin*, 161 Ill. 417; *Gunderson* v. *Illinois Trust and Savings Bank*, 199 id. 422.

The statute prescribes a certain course to be pursued in organizing a corporation in this State. It does not necessarily follow, however, that any departure from that course will prevent a corporation from becoming one *de jure*. Whether or not such departure will have that effect depends upon the nature of the provision which is violated. If it is a mandatory provision, a failure to substantially comply with its terms will prevent the corporation from becoming one *de jure;* but if the provision is merely directory, then a departure therefrom will not have that consequence.

In Cooley's Constitutional Limitations (star page 78) it is said: "Those directions which are not of the essence of the thing to be done, but which are given with a view merely to the proper, orderly and prompt conduct of the business, and by a failure to obey which the rights of those interested will not be prejudiced, are not commonly to be regarded as mandatory; and if the act is performed, but not in the time or in the precise mode indicated, it may still be sufficient, if that which is done accomplishes the substantial purpose of the statute."

The provision of the statute here under consideration, requiring notice of the first meeting to be given to the subscribers to the capital stock of a corporation being organized, by mailing to them notices stating the object, time and place of such meeting, at least ten days before the time fixed for such meeting, is evidently intended only as a direction "given with a view merely to the proper, orderly and prompt conduct" of the commissioners in calling such meeting, and a failure to obey that provision will not prejudice the rights of any persons interested therein if the same result is reached in some other mode. The only persons interested in the result to be attained by giving notice of the object, time and place of a meeting of the subscribers to the capital stock of a corporation for the purposes specified in the statute are the subscribers themselves. We perceive no reason why such persons, where all agree thereto, may not waive the giving of the statutory notice, if the meeting is actually held, as the purpose of the statute in requiring the notices to be given has in such case been accomplished.

The mere fact that the word "shall" is used in the statute in providing for the notice does not render the provision mandatory. *Canal Commissioners* v. *Sanitary District*, 184 Ill. 597.

In the case of *Newcomb* v. *Reed*, 12 Allen (Mass.) 362, in discussing the effect upon the legality of a corporation where the call for the first meeting was signed by only one of the persons named in the act of incorporation instead of by a majority of such persons, as required by the statute of Massachusetts, the court said: "The organization was not strictly regular, but can hardly be considered even as defective. And if the object of the statute is regarded, by which it is required that the first meeting shall be called by a majority of the persons named in the act of incorporation, it will be evident that it is directory, merely, and only designed to secure the rights conferred by the charter to those to whom it was granted, among themselves, by providing an orderly method of organization. Thus, if all the persons interested should come together without any notice or call whatever, and proceed to accept the charter and do the other acts necessary to constitute the corporation, we cannot doubt that their action would be valid, and that neither the public, nor any persons not belonging to the association, would have any interest to question their proceedings. The purpose of the statute was probably to avoid such difficulties as were disclosed in the case of *Lechmere Bank* v. *Boynton*, 11 Cush. 369, where two parties had attempted to organize separately under the same charter, each claiming to be the corporation."

Cases have also arisen in this State in which the effect of a failure to give notice of corporate meetings in the manner provided by statute have been considered, and it has been uniformly held that it is immaterial whether or not such notice has been given in the man-

ner pointed out by the statute, if the persons entitled to such notice actually attend the meeting and participate in the business there transacted. *Thomas* v. *Citizens' Horse Railway Co.*, 104 Ill. 462; *Gade* v. *Forest Glen Brick Co.*, 165 id. 367.

This case is distinguishable from *Loverin* v. *McLaughlin*, *supra*, which is relied upon by appellant, in that notice of the first meeting of subscribers is not intended for the benefit of the public, as no publicity of such meeting is required, but is merely for the benefit of the subscribers, while in the *Loverin case* the provision which was not complied with was that requiring the certificate of complete organization issued by the Secretary of State to be filed and recorded in the office of the recorder of deeds of the county in which the principal office of the corporation is located, and a compliance with the statute in that regard was essential because the provision was one for the benefit of the public, and could not be waived.

It is urged that the fact that section 4 of the act in question requires a copy of the notice provided for by section 3, *supra*, to be included in the report made to the Secretary of State, shows that the statute contemplates compliance with the statute in regard to giving notice. We think this provision is fully satisfied by including in such report the written instrument signed by all the subscribers in which such notice is waived.

The superior court did not err in refusing the propositions of law and in entering judgment upon the stipulation of facts in favor of the defendants and against the plaintiff for costs.

The judgment of the Appellate Court will be affirmed.

Judgment affirmed.

NOTE. — See, *accord*, *Judah* v. *American Live Stock Co.*, 4 Ind. 333, 339; *Braintree Water Supply Co.* v. *Braintree*, 146 Mass. 482, 488; *Ossipee Co.* v. *Canney*, 54 N.H. 295, 312; *Jackson* v. *Crown Point Co.*, 21 Utah, 1; *Grays* v. *Turnpike Co.*, 4 Rand. (Va.) 578, 581.

MOKELUMNE CO. *v.* WOODBURY.

14 Cal. 424. 1859.

COPE, J., delivered the opinion of the Court — BALDWIN, J., and FIELD, C.J., concurring.

It is alleged in the complaint that the plaintiff is a corporation, and this allegation being denied in the answer, the case was tried in the court below upon that issue alone. The plaintiff dates its corporate existence as far back as 1852, and claims to have been duly and regularly incorporated under the general act of 1850, providing for the formation of corporations for manufacturing, mining, mechanical, and chemical purposes. Section 122 of that act provides that any three or more persons, who may desire to form a com-

pany for either of these purposes, "may make, sign, and acknowledge, before some officer competent to take the acknowledgment of deeds, and file in the office of the clerk of the county in which the business of the company shall be carried on, and a duplicate thereof in the office of the Secretary of State, a certificate in writing," etc. Section 123 provides, that "when the certificate shall be filed as aforesaid," the persons executing the same and their successors, shall be a body politic and corporate. Section 130 provides, that "the copy of any certificate of incorporation filed in pursuance of this act, certified by the county clerk or his deputy to be a true copy, and of the whole of such certificate, shall be received in all courts and places as presumptive legal evidence of the facts therein stated. On the trial of the case, it was shown that a certificate, in conformity with the requirements of the act, had been filed in the office of the clerk of the proper county, and a certified copy thereof was produced and read in evidence, but it was not shown that a duplicate had been filed in the office of the Secretary of State. It appeared in proof that the company had been doing business as a corporation since 1852, but the court held, that as it was not shown that a duplicate had been filed as required by the act, the evidence did not establish the fact of incorporation.

The general rule is, that the existence of a corporation may be proved by producing its charter, and showing acts of *user* under it; but this rule has no application to a corporation formed under the provisions of a general statute, requiring certain acts to be performed before the corporation can be considered *in esse*, or its transactions possess any validity. The existence of a corporation thus formed, must be proved by showing at least a substantial compliance with the requirements of the statute. But there is a broad and obvious distinction between such acts as are declared to be necessary steps in the process of incorporation, and such as are required of the individuals seeking to become incorporated, but which are not made prerequisites to the assumption of corporate powers. In respect to the former, any material omission will be fatal to the existence of the corporation, and may be taken advantage of, collaterally, in any form in which the fact of incorporation can properly be called in question. In respect to the latter, the corporation is responsible only to the government, and in a direct proceeding to forfeit its charter. The right of the plaintiff to be considered a corporation, and to exercise corporate powers, depends upon the fact of the performance of the particular acts named in the statute as essential to its corporate existence. Under the issues presented in the pleadings, there is no doubt that performance of these acts should have been shown, and if the filing of the duplicate of the certificate of incorporation is to be regarded as one of them, the court below properly held that the existence of the corporation had not been established. But we do not see upon what principle such a construction of the

statute is admissible. It is certainly not justified by the natural and ordinary import of the language used, which must furnish the rule of construction unless a contrary intention clearly appear. Section 122 of the act provides, as we have seen, for the filing of a certificate with the clerk, and a duplicate with the Secretary of State; but Section 123 declares that when the *certificate* shall be filed, the persons executing the same and their successors, shall be a body politic and corporate. The intention of the legislature clearly was, that so far as individuals are concerned, the corporation should acquire a valid legal existence upon the filing of the certificate. The filing of the duplicate is exclusively a matter between the corporation and the State. The rights and privileges conferred by the statute vest in the corporation upon the filing of the certificate, and can be divested only by a direct proceeding for that purpose. If the duplicate has not been filed, the assumption of corporate powers amounts simply to a usurpation of the sovereign rights of the State, the remedy for which rests with the State alone.

Judgment reversed, and cause remanded for a new trial.

NOTE. — No case comes within the scope of the doctrine of *de facto* corporations (see the Book on "Unauthorized Corporate Action," *infra*) if the failure to comply with the legislative enactments is within the doctrine of *People* v. *Stockton R.R. Co.*, *supra*, or of *Butler Paper Co.* v. *Cleveland*, *supra*, or of the principal case.

The doctrine of *de facto* corporations is reached only when the court feels bound to hold that the defect in organization amounts to a failure substantially to perform a mandatory provision, the performance of which the legislature intended should be a condition precedent to incorporation.

Failure to conform to the legislative command may be intended to be merely a cause of forfeiture of the corporate franchise, to be enforced at the option of the State alone, and in such case no collateral attack upon the legal existence of the corporation will be permitted. See *Sparks* v. *Woodstock Co.*, 87 Ala. 294; *Chiniquy* v. *Catholic Bishop of Chicago*, 41 Ill. 148, 156 (corporation sole); *Walton* v. *Riley*, 85 Ky. 413; *Lord* v. *Essex Ass'n*, 37 Md. 320, 326; *Merrick* v. *Reynolds Co.*, 101 Mass. 381; *In re Shakopee Co.*, 37 Minn. 91; *Granby Mining Co.* v. *Richards*, 95 Mo. 106; *Vanneman* v. *Young*, 52 N.J.L. 403; *Hughesdale Co.* v. *Vanner*, 12 R.I. 491; *Cheraw Co.* v. *White*, 14 S.C. 51; *Harrod* v. *Hamer*, 32 Wis. 162; *Wells Co.* v. *Gastonia Co.*, 198 U.S. 177.

Even if the legislature enacts that, in a certain event, the grant of the corporate franchise shall be null and void, the courts strongly incline to hold that, on the happening of the event, the corporate existence is not, *ipso facto*, ended, but that there is merely a cause for its forfeiture. See *Brown* v. *Wyandotte Co.*, 68 Ark. 134, and cases cited.

CHAPTER II.

DISTINGUISHING A CORPORATION FROM AN UNINCORPORATED ASSOCIATION.

A. Where there is no Legislative Enactment.

TAPPAN *v.* BAILEY.

4 Met. (Mass.) 529. 1842.

Assumpsit by the indorsee of the following note: "Norridgewock, Me., April 1st, 1837. For value received I promise to pay Albert G. Manley, or his order, three hundred dollars, at the Lincoln Bank in Bath, on the first day of September, 1838, with interest after the first day of July next. David Wilder, Jr., as agent of the Kennebec Lumber Co."

At the trial, the plaintiff, in order to prove that the defendants were members of the Kennebec Lumber Company, and that Wilder was the agent of the company, introduced evidence tending to show that there was a company, of many individuals, formed in the county of Worcester, in 1835, to purchase a township of land in Maine, and to manage the same by disposing of the lumber upon it; that the defendants had either attended the meetings of the company, or acknowledged themselves to be members of it; and, among other evidence, he introduced articles of agreement, whereby sundry persons associated together as the Kennebec Lumber Company; which agreement was signed by the defendants, among others.

This agreement contained the following provisions: —

And it has been agreed and is intended by all the several persons, parties to this indenture, of the first part, that they, with their associates, shall form a joint stock company, under the name and style of the Kennebec Lumber Company, to raise the sum of $123,168, as a capital stock, to be divided into one hundred shares of the value and price of $1232 each. That each person shall be entitled to so many shares thereof, as shall be subscribed for by him after his signature to this indenture. And it is further intended and agreed, that all such real estate described in said deed [namely, a deed of certain woodland in Maine], and such as may be hereafter purchased by said company, shall be vested in trustees, to hold upon the trusts herein contained, and manage and improve the same for the benefit of said

parties of the second part, their heirs, executors, administrators and assigns, as and in the nature of personal estate, and in proportion to the number of shares owned and held by each, respectively.

That the several persons, parties to this indenture, of the first part, with their associates and successors, shall be and continue an association and joint stock company of proprietors, under the name and style of the Kennebec Lumber Company, from the day of the date hereof until the dissolution thereof in manner hereinafter provided, and will each be subject to observe and well and truly perform the terms, articles and regulations, hereinafter contained, etc.

Art. 15. At the annual meeting of the proprietors, they shall elect by ballot from their number a president and five directors. The president shall be, *ex officio*, member of the board of directors, etc.

Art. 16. The president shall preside, etc., and exercise general supervision over all the concerns of the company, and the conduct of its officers.

Art. 20. The directors shall have the general management and superintendence of the business and affairs of the company, subject to the votes, orders and control of the proprietors in their meetings, and shall do all things necessary and proper to carry the same fully into effect.

Art. 21. The directors may employ all such agents as shall be needed to transact the business of the company in the best manner, and shall determine the reasonable compensation to be allowed to the trustees and other officers and agents.

Art. 26. The directors shall have the control, management and administration of all the affairs, and prudential and pecuniary concerns of the company, in all cases not otherwise provided for in and by this indenture.

Art. 35. The books of records of the company shall be open at all times to the inspection of any proprietor, trustee or officer, and shall be admissible evidence of all facts contained therein, in all suits and questions between the persons who may become parties to this indenture, and those claiming under them.

The plaintiff also introduced evidence tending to prove the agency of Wilder.

SHAW, C. J. Upon the general question, the court are of opinion, that the articles constitute the signers a joint stock company, unincorporated, and thereby made them partners. Looking at the general purposes expressed in the articles, and the name assumed by the company, indicating that they were not a mere land company, to purchase lands, in the expectation of a profit on the resale; and considering the manner in which they immediately went into operation, there is sufficient evidence to show, that the object of this partnership was, that of felling and getting out lumber from the tract of land mentioned in the articles, and other tracts of land in Maine, contem-

plated to be bought; preparing and getting such lumber to market; and selling it for the mutual profit and benefit of the shareholders. And it is a well-known rule of law, that an agreement to carry on business by two or more jointly, and to share the profits, makes them responsible for all losses, and binds them by all contracts made by any of the partners or their agents, which are necessarily incident to carrying on the contemplated business.

The court was of opinion that the plaintiff had proved the agency of Wilder.

Defendants defaulted.

NOTE. — *King* v. *Dodd*, 9 East, 516. The defendant published and circulated a "Prospectus for the London Paper Manufacturing Company." It was proposed to raise by subscription £50,000 by transferable shares payable by installments, the whole to be under a deed of trust or enrolment in chancery "by which no party (it was said) could be accountable for more than the sum subscribed under the regulations therein stipulated." Lord ELLENBOROUGH said (p. 527): "There is besides in this prospectus a prominent feature of mischief; for it therein appears to be held out that no person is to be accountable beyond the amount of the share for which he shall subscribe, the conditions of which are to be included in a deed of trust to be enrolled. But this is a mischievous delusion, calculated to ensnare the unwary public. As to the subscribers themselves, indeed, they may stipulate with each other for this contracted responsibility; but as to the rest of the world it is clear that each partner is liable to the whole amount of the debts contracted by the partnership."

PHILLIPS *v.* BLATCHFORD.

137 Mass. 510. 1884.

BILL in equity, filed November 9, 1881, against the surviving executor of the will of Marshall S. Scudder, for contribution. The bill, as amended, alleged the following facts: —

On or about June 1, 1874, certain persons entered into a copartnership styled the Ryder Reciprocal Grate Association, under a declaration of trust, by the terms of which no member, as such, was to have any control over the business of the association, which was to be entirely under the control of a board of managers, of whom the trustee was to be a member, and the other members were to be elected by the shareholders. The stock was to be divided into fifteen hundred shares, and each holder of a share was entitled to a certificate, which might be transferred by an assignment in writing. The following provision was made in case of the death of a member: "The decease of a member of the association shall not work a dissolution of it, nor shall it entitle his legal representatives to an ac-

count, or to take any action in the courts or otherwise, against the association or the trustee, for such; but they shall simply succeed to the right of the deceased to the certificate and the shares it represents, subject to this declaration of trust."

The defendant's testator became the owner of one hundred and twenty-five shares in the association, on or about June 1, 1874, and was such owner at the time of his death, on August 28, 1875. On October 11, 1875, the defendant and John P. Putnam, since deceased, were appointed executors of his will.

The association in the prosecution of its business became indebted to the Taunton Iron Works Company. This indebtedness was incurred partly before and partly after the death of Scudder. On June 18, 1878, the Taunton Iron Works Company brought an action against the plaintiff and other members of the association, to recover the debt. On November 12, 1880, the plaintiff and Sylvanus N. Staples each paid one half of the amount of said claim, which amounted in the whole to the sum of $6934.78. The association also became indebted in the sum of $1625.27 to the firm of Staples and Phillips, which firm was composed of the plaintiff and Sylvanus N. Staples, and on February 28, 1879, said indebtedness was paid by the plaintiff by the account being charged to profit and loss on the books of the firm.

The number of shares in the association held by solvent persons in Massachusetts was one hundred and eighty-nine; and on November 12, 1880, the plaintiff presented a petition to the Probate Court, setting forth the payment by the plaintiff of the claim of the Taunton Iron Works Company, and the liability of Scudder to the plaintiff growing out of such payment; and the Probate Court, on December 20, 1880, ordered the executors of the will of said Scudder to retain in their hands the sum of $4000 until the rendering of final judgment in any suit at law or in equity commenced within one year after payment of the claim.

The prayer of the bill was that the defendant be ordered to pay $\frac{125}{189}$ of the claims paid by the plaintiff, and for further relief.

HOLMES, J. It is admitted that the partnership was formed under a declaration of trust, by which it was provided, among other things, as follows: "The decease of a member of the association shall not work a dissolution of it, nor shall it entitle his legal representatives to an account, or to take any action in the courts or otherwise, against the association or the trustee, for such; but they shall simply succeed to the right of the deceased to the certificate and the shares it represents, subject to this declaration of trust."

The main question is whether this provision is broad enough to make the estate of a shareholder liable to contribute to the other partners for debts incurred after his decease, and before the executor has done any act by which he becomes a partner in the testator's

place. In the opinion of the majority of the court, the provision has that effect. It may be conceded that, without some act on his part, the executor would not become a partner; and, for the purposes of this case, it may also be conceded that the estate in the executor's hands would not be liable to creditors for such a debt, unless the executor was personally bound. There might be some difficulty in showing how such a new contract could be made with a dead man, and it might be said that our law does not recognize an estate as a *universitas* able to contract, or know any way of binding an executor otherwise than personally by a contract made after the testator's death. See *Labouchere* v. *Tupper*, 11 Moore P.C. 198; *Owen* v. *Delamere*, L.R. 15 Eq. 134.

But a man may contract with his copartners to indemnify them for a certain proportion of liabilities incurred after his death; and, if such liabilities are incurred, his executor will be bound *de bonis testatoris* in the same way that he is by any other contract of his testator, and without introducing any anomalous principle whatever. *Turquand* v. *Kirby*, L.R. 4 Eq. 123, 134. See *Hammond* v. *Granger*, 128 Mass. 272; *Bacon* v. *Pomeroy*, 104 Mass. 577, 582.

Ordinarily, when a partner contracts that his share in the profits shall continue to a certain time, he contracts by implication that his liability for losses shall have the same duration. We see no reason why this principle should not apply when the time extends beyond the partner's life. And when, as here, a company is purposely made as nearly a corporation as possible, and it is obviously intended that the death of a shareholder shall not affect either the company or the rights incident to the share, we think that the liabilities go with the rights, and that the effect of the testator's contract was that he would share losses until his estate was relieved of his shares in the stock. *In re Agriculturist Cattle Ins. Co.*, L.R. 5 Ch. 725.

When a partner merely reserves an option to his executor to take his place in the firm, and perhaps even when he covenants that his executor shall take his place, but does no more, the interest of his estate in the profits after his death, and therefore its liability for losses, are dependent upon the executor's personal participation in the business; so that, if the executor declines, the firm will be dissolved by the death, and an account must be taken, although the surviving partner may be entitled to damages. See *Downs* v. *Collins*, 6 Hare, 418.

But the present contrivance goes farther, and, as we have said, is intended to imitate a corporation so far as to stipulate that profits and losses shall follow the certificate, and that the certificate shall remain part of the estate of the deceased, whether the executor makes himself a member of the company or not.

NOTE. — See *Hossack* v. *Ottawa Ass'n*, 244 Ill. 274.

WILLIAMS *v.* MILTON.

215 Mass. 1. 1913.

FOUR petitions to the Superior Court under St. 1909, c. 490, Part I, § 76, by the trustees of the Boston Personal Property Trust, in the first three cases appealing from refusals of the assessors respectively of the town of Milton, the city of Waltham, and the town of Brookline to abate taxes assessed on April 1, 1911, on personal property held by the petitioners as such trustees alleged to be apportionable under St. 1909, c. 490, Part I, § 23, cl. 5, to beneficiaries or trustees whose places of residence were respectively in Milton, Waltham, and Brookline, and in the fourth case appealing from a refusal of the assessors of the city of Boston to abate taxes upon the full amount of the personal property held by the petitioners as such trustees which were assessed to the petitioners on the same date under St. 1909, c. 490, Part I, § 27, on the ground that such property was the personal property of a partnership carried on in Boston.

The petitions were heard together by QUINN, J., upon an agreed statement of facts. In the cases against the town of Milton, the city of Waltham, and the town of Brookline the judge found that the petitioners were entitled to the abatements respectively claimed in those cases and ordered that judgments should be entered accordingly, and in the case against the city of Boston he found that the petitioners were entitled to no abatement and ordered that judgment should be entered for the respondent. At the request of the parties he reported the cases for determination by this court.

The indenture of trust creating the Boston Personal Property Trust was dated January 10, 1893. Among other provisions bearing upon the character of the trust were the following: —

"Second. That the said Trustees shall hold all the funds and property (hereinafter called the Trust Fund), now or hereafter held by or paid to, or transferred or conveyed to them or their successors as Trustees hereunder in trust for the purposes, with the powers and subject to the limitations hereinafter declared, for the benefit of the *cestuis que trustent*, and it is hereby expressly declared that a trust, and not a partnership, is hereby created; that neither the Trustees nor the *cestuis que trustent* shall ever be personally liable hereunder as partners or otherwise, but that for all debts the Trustees shall be liable as such to the extent of the Trust Fund only. In all contracts or instruments creating liability, it shall be expressly stipulated that the *cestuis que trustent* shall not be liable."

"Fourth. (*a*) The Trustees shall have as full power and discretion, as if absolute owners, to invest and reinvest the Trust Fund (including any surplus and also income) in personal property, including bonds and notes or obligations secured upon real estate, and

the decision of the Trustees as to what is personal property shall be final. They shall have the like power of investment in the purchase and improvement of real estate in the cities of the United States of America, for the purpose of leasing the same upon long terms, or ground rents so-called; and all real estate so purchased shall be conveyed to them in joint tenancy as Trustees hereunder."

"(*e*) The Trustees shall also have power at any time to borrow money, and to pledge, as collateral security for such loan, any personal property belonging to the Trust Fund, provided, however, that no loan shall be contracted for, so that the aggregate amount of such loans outstanding shall at such time exceed, in the judgment of the Trustees, twenty-five per cent of the total amount of the personal property of the Trust Fund."

"Seventh. The Trustees shall declare dividends from the net income of the Trust Fund among the *cestuis que trustent* quarterly, or oftener, if convenient to the Trustees, and their decision as to amount of dividends, and as to using therefor any portion of the Surplus Fund, shall be final. They may set aside from time to time such portion of the net income as shall not be required for dividends for a Surplus Fund."

"Ninth. The Trustees shall render an account annually or oftener, if convenient to them, and shall, upon request, deliver or mail a copy to each *cestui que trust*."

"Tenth. Any Trustee may resign his trust by a written instrument signed and sealed by him, and acknowledged in the manner prescribed for the acknowledgment of deeds, and such instrument may be recorded in the Registry of Deeds for the County of Suffolk, or deposited with such Depositary as the Trustees shall from time to time select.

"Any vacancy occurring from any cause at any time in the number of said Trustees shall be filled by the remaining Trustees. . . . "

"Fourteenth. The Trustees shall issue a certificate, in such form as they shall deem best, to each person who shall pay them the sum of one thousand dollars or multiple thereof, for an interest in the Trust Fund. But no certificate shall be issued for any less sum than one thousand dollars, at par value. . . . "

"Fifteenth. The interests represented by the certificates may be transferred on the books of the Trustees by the person named therein, or his legal representative, upon the surrender of the certificate, and a new certificate shall be issued to the transferee, who shall thereupon become a *cestui que trust*. But no such interest shall be sold until the holder thereof (including assignees in insolvency or bankruptcy, or for benefit of creditors, and holders by process of law or otherwise, except as hereinafter stated) shall have first in writing offered it for sale to the Trustees, who shall, as such Trustees, have the option for ten days after the receipt of such offer of buying the same at not

more than the last preceding appraisal made by them, such appraisal to be made annually or oftener as they shall deem best. Interests so purchased by the Trustees may be held as part of the Trust Fund, or sold by them at their discretion.

"Devises by will, distribution of the estates of deceased persons according to law, and distribution of trust funds among those entitled thereto upon the termination of trusts, shall not be deemed sales for the purposes hereof."

"Twentieth. The Trustees may, with the consent of three-fourths in interest of the *cestuis que trustent*, alter or add to this Declaration, or terminate this Trust, and if it seems to them judicious so to do, they may, with like consent, convey the Trust Fund to new or other Trustees, or to a corporation, being first duly indemnified for any outstanding obligation or liability. . . ."

LORING, J. These are four petitions for the abatement of taxes assessed upon the plaintiffs as trustees of the Boston Personal Property Trust. The Boston taxes were assessed on the theory that the property held by the plaintiffs under that trust was partnership property to be assessed under St. 1909, c. 490, Part I, § 27, in Boston where the partnership (if there was a partnership) had its place of business. The other taxes were assessed upon the theory that the property held by the plaintiffs under that trust was held by them as trust property the income of which was payable to another person and was to be assessed under St. 1909, c. 490, Part I, § 23, cl. 5.

It has been contended in effect if not in terms that, whatever may be its true character, the trust for the purposes of taxation was a partnership. Doubtless the legislature might provide that a trust which was not a partnership should be treated as a partnership for the purposes of taxation. But it has not done so. What the legislature has done is to provide (1) that "personal property held in trust by an executor, administrator or trustee, the income of which is payable to another person, shall be assessed to the executor, administrator or trustee in the city or town in which such other person resides, if within the Commonwealth," and if he resides out of the Commonwealth, in the place where the trustee resides; St. 1909, c. 490, Part I, § 23; and (2) that "Partners, whether residing in the same or in different cities or towns, may be jointly taxed under their firm name, in the place where their business is carried on, for all the personal property employed in such business, except ships or vessels." St. 1909, c. 490, Part I, § 27. That is to say, the legislature has provided that the right to tax property as trust or as partnership property depends upon the real character of the property taxed. Under these enactments of the legislature there is no room for holding that property which is in reality not partnership property can be taxed as partnership property. The right to tax property as trust or as partnership property depends upon what the character of the property taxed really is.

We proceed to a discussion of the principles on which the question of the true character of the Boston Personal Property Trust depends.

Where persons associate themselves together to carry on business for their mutual profit, they are none the less partners because (1) their shares in the partnership are represented by certificates which are transferable and transmissible, and because (2) as a matter of convenience (if not of necessity in case of transferable and transmissible certificates) the legal title to the partnership property is taken in the name of a third person. The person in whose name the partnership property stands in such a case is perhaps in a sense a trustee. But speaking with accuracy he is an agent who for the principal's convenience holds the legal title to the principal's property.

Several instances of such partnerships are to be found in our reports. In *Hoadley* v. *County Commissioners*, 105 Mass. 519, one Gordon McKay executed a declaration of trust by which he declared that he held his patents for sewing the soles of boots and shoes to the vamps, his factory where machines were manufactured under these pàtents and the whole business theretofore carried on by him, in trust for such persons as should buy certificates which were to be issued under that declaration of trust to the amount of fifty thousand in number, the proceeds to be used in carrying on the factory and business assigned to and held by the trustee. The certificate holders were to be known as the McKay Sewing Machine Association and the business was to be conducted by an executive committee to be chosen by them. This was held to create a partnership, and for that reason the shares were held not to be taxable to the holders of them. For a subsequent case involving the same association, where the same conclusion was reached, see *Gleason* v. *McKay*, 134 Mass. 419. In *Whitman* v. *Porter*, 107 Mass. 522, certain subscribers associated themselves together to buy a ferry boat to be run between Agawam and Springfield; the boat was to be conveyed to one of the subscribers in "trust" and the entire business was to be conducted by the trustees and their officers to be annually elected by the subscribers. The stock was assignable. These stockholders were held to be partners. In *Phillips* v. *Blatchford*, 137 Mass. 510, the money to carry on the business of manufacturing and selling grates was raised by the sale of transferable certificates issued under a somewhat similar declaration of trust which provided that the business should be carried on by a board of managers of whom the trustee was to be one, and the other members were to be elected by the shareholders. This also was held to be a partnership. In *Ricker* v. *American Loan & Trust Co.*, 140 Mass. 346, the doctrine of these cases was extended to a case where the purpose of the association was to buy cars to be leased to a specified railroad. The persons providing the purchase money were to have transferable certificates, which certificates by

the terms of the lease to the railroad were to be paid in ten annual instalments with six per cent interest until paid. The certificate holders were declared in the declaration of trust to be an association, and all the business was to be transacted by a board of managers to be elected by them. The property of the association was to be held by the American Loan and Trust Company as trustee. This also was held to be a partnership. *Williams* v. *Boston*, 208 Mass. 497, was a similar case. The trust agreement in that case provided that the trust was established "for the purchase, development, and disposition of" the former site of the Museum of Fine Arts in Boston. The property was to be held by trustees, but the shareholders had a right to remove the trustees, and meetings of the shareholders were to be held at which the shareholders might authorize or instruct the trustees in any manner and alter or amend the declaration of trust, or direct the trustees to end the trust, sell the property and distribute the proceeds. The original papers in the case show these to have been the facts of the case although they are not stated in the report of that decision. The property of this association was held to be taxable as partnership property.

In *Mayo* v. *Moritz*, 151 Mass. 481, on the other hand, it was held that certificate holders under the declaration of trust there in question were not partners. In that case an inventor transferred his invention to trustees to whom by the terms of the trust indenture the patent was to be issued when it was issued. The trust indenture provided for the issue of scrip to those who should furnish to the trustees the money necessary for the more advantageous disposition of the invention. The trust, on which the trustees were to hold the invention and the money produced by the issue of scrip, was to hold, manage and dispose of the invention or any part thereof or interest therein upon such terms as to them (the trustees) or a majority of them should seem best, the net proceeds to be paid one half to the inventor and the other half to the holders of the scrip or certificates. The scrip, called in the trust indenture scrip or certificates, was transferable. Vacancies in the office of trustee were to be filled by the remaining trustees. It was held that the scrip-holders were not partners, and in that respect the case was "unlike *Gleason* v. *McKay*, 134 Mass. 419, and *Phillips* v. *Blatchford*, 137 Mass. 510."

The difference between *Hoadley* v. *County Commissioners*, 105 Mass. 519 (involving the same indenture as that in *Gleason* v. *McKay*, 134 Mass. 419), *Whitman* v. *Porter*, 107 Mass. 522, *Phillips* v. *Blatchford*, 137 Mass. 510, *Ricker* v. *American Loan & Trust Co.*, 140 Mass. 346, and *Williams* v. *Boston*, 208 Mass. 497, on the one hand, and *Mayo* v. *Moritz*, 151 Mass. 481, on the other hand, lies in the fact that in the former cases the certificate holders are associated together by the terms of the "trust" and are the principals whose instructions are to be obeyed by their agent who for their convenience

holds the legal title to their property. The property is their property. They are the masters. While in *Mayo* v. *Moritz* on the other hand there is no association between the certificate holders. The property is the property of the trustees and the trustees are the masters. All that the certificate holders in *Mayo* v. *Moritz* had was a right to have the property managed by the trustees for their benefit. They had no right to manage it themselves nor to instruct the trustees how to manage it for them. As was said by C. ALLEN, J., in *Mayo* v. *Moritz*, 151 Mass. 481, 484: "The scrip-holders are *cestuis que trust*, and are entitled to their share of the avails of the property when the same is sold," and that is all to which they were entitled. In *Mayo* v. *Moritz* the scrip-holders had a common interest in the trust fund in the same sense that the members of a class of life tenants and the members of a class of remaindermen (among whom the income of a trust fund and the corpus are to be distributed respectively) have a common interest. But in *Mayo* v. *Moritz* there was no association among the certificate holders just as there is no association although a common interest among the life tenants or the remaindermen in an ordinary trust. For a decision in this Commonwealth somewhat like *Mayo* v. *Moritz*, *ubi supra*, see *Hussey* v. *Arnold*, 185 Mass. 202. See also in this connection *Makin* v. *Savings Institution at Portland*, 23 Maine, 350; *Burt* v. *Lathrop*, 52 Mich. 106.

There is a case in England (*Smith* v. *Anderson*, 15 Ch.D. 247) in which the distinction between cases like *Hoadley* v. *County Commissioners* and *Mayo* v. *Moritz*, was pointed out and established, and that case is now the established law in England. In *Smith* v. *Anderson* (decided by the Court of Appeals in 1880), the trust deed provided for the purchase by trustees of shares in the capital stock of eleven different submarine telegraph companies. The money was to be furnished by subscribers to whom transferable certificates were to be issued. The income derived from the submarine shares and the proceeds of any sales of them were to be applied by the trustees (1) in paying six per cent interest on the trust certificates issued under the trust; (2) in redeeming these trust certificates at £120; and finally, when (3) all the certificates had been redeemed, the surplus, if any, was to be divided among the former certificate holders. It was held that this was a trust and not a company association or partnership which had to be registered under companies act of 1862 (St. 25 & 26 Vict. c. 89), § 4. That act provided that "No company, association or partnership . . . shall be formed . . . for the purpose of carrying on any other business [that is to say, any business other than banking] that has for its object the acquisition of gain by the company, association, or partnership, or by the individual members thereof, unless it is registered." This conclusion was reached on the ground that there is a difference between a partnership where money raised by the issue of transferable certificates is to be held by so-called

trustees who are really managing agents, and a trust where money raised by the issue of transferable certificates is to be held by trustees properly so called, and that the distinction between the two is that which we have just stated in detail.

The decision in *Smith* v. *Anderson* is the law of England to-day, although by reason of some special facts in that case and the way in which the question arose doubts as to the conclusion reached in that case have been thrown out by two or three individual judges. For the subsequent cases see *Crowther* v. *Thorley*, 32 W. R. 330; *In re Siddall*, 29 Ch.D. 1; *In re Jones*, [1898] 2 Ch. 83, 91. For two cases where the distinction between managing agents who hold the legal title and trustees properly so called is reaffirmed, see *In re Thomas*, 14 Q.B.D. 379, 383; *In re Faure Electric Accumulator Co.*, 40 Ch.D. 141, 151, 152.

This brings us to the question of the character of the Boston Personal Property Trust. It is plain that it is a trust and not a partnership. By the terms of the indenture of trust the property contributed by the certificate holders, or that bought with money contributed by them (the original trust property could be acquired in both ways by the terms of the indenture of trust), was to be held by the trustees in trust to pay the income to the holders of the certificates, and on the termination of the trust to divide the trust fund or the proceeds thereof among them. The certificate holders are throughout called "*cestuis que trustent.*" The certificate holders, or "*cestuis que trustent,*" are in no way associated together, nor is there any provision in the indenture of trust for any meeting to be held by them. The only act which (under the trust indenture) they can do is to consent to an alteration or amendment of the trust created by the indenture or to a termination of it before the time fixed in the deed. But they cannot force the trustees to make such alteration, amendment or termination. It is for the trustees to decide whether they will do any one of these things. All that the certificate holders or "*cestuis que trustent*" can do is to give or withhold their consent to the trustees taking such action. And the giving or withholding of consent by the *cestuis que trust* is not to be had in a meeting, but is to be given by them individually. As we have said, no meeting of the *cestuis que trust* for that or any other purpose is provided for in the trust indenture. The trustees of the Boston Personal Property Trust have a right to sell the trust securities and reinvest the proceeds, and also a limited power to borrow on the security of the trust property. The certificate holders, or "*cestuis que trustent,*" as they are called in the trust deed, have a common interest in precisely the same sense that the members of a class of life tenants (among whom the income of a trust fund is to be distributed) have a common interest, but they are not *socii*, and it is the trustees, not the certificate holders, who are the masters of the trust property. The sole right of the *cestuis que*

trust is to have the property administered in their interest by the trustees, who are the masters, to receive income while the trust lasts, and their share of the corpus when the trust comes to an end.

It has been urged by the learned counsel for the city of Boston that these certificate holders or "*cestuis que trustent*" are in effect carrying on the business of buying and selling securities through the trustees as managing agents or directors, and he refers to two facts which (he argues) bear him out in that contention, namely, (1) that the trustees on April 1, 1911, had on hand undivided income to the amount of $51,516.93, and a "surplus capital" amounting to $488,-566.35. By the terms of the trust the trustees are authorized to set aside from time to time such portion of the net income as shall not be required for dividends for a "Surplus Fund," which surplus fund may be subsequently used by them in their discretion in payment of dividends. It appears that the face value of the outstanding certificates is $2,090,500. The surplus fund of undivided income therefore amounts to about two and a half per cent of the corpus of the fund. The surplus capital of $488,566.35 is about twenty-three and one half per cent of the face value of the outstanding certificates. That is not an extraordinary increase in the value of the corpus of the trust fund during a period of eighteen years. But this contention brings out a fact in addition to those already referred to, which shows that the Boston Personal Property Trust is not a partnership, but a trust and nothing but a trust. When persons engage as partners in buying and selling stocks, bonds and other securities for their mutual profit, the gains made by purchases and sales are profits of the partnership, divisible as such among those entitled to the profits of the partnership. In case of a trust on the other hand, any gain made by a change of investments is an accretion belonging to the corpus of the trust fund and belongs to those who own the corpus of the fund. Such gains become part of the corpus as much as the original money contribution to the trust fund. On them the certificate holders, or "*cestuis que trustent*," are entitled to income while the trust lasts, and to their share of them (because they are included in the corpus of the trust fund) when the trust ends and there is a distribution of the corpus among the *cestuis que trust*. That is the way in which the trustees of the Boston Personal Property Trust have dealt with gains made by changes of investment of the securities of that trust. That is to say, the trustees have treated gains from sales of securities not as profits of a partnership organized to buy and sell stocks for a profit, but as gains on a change made in the investments of a trust fund.

It was largely with respect to the gains made by sales of the securities of the trust that the special circumstances in *Smith* v. *Anderson* raised a doubt as to that being a trust for investment and not a "business that has for its object the acquisition of gain." It was provided in the trust deed in *Smith* v. *Anderson* that the submarine

telegraph shares should not be sold unless they brought a premium of thirty per cent, and that the proceeds of such sales should be used in the same way that the annual income derived from the submarine telegraph shares should be used, namely, in paying interest on the trust certificates and in retiring those certificates at £120 a share. They were issued originally at £90 per share. In that respect the trust in question in *Smith* v. *Anderson* was quite different from the Boston Personal Property Trust. There is nothing in the trust deed of the Boston Personal Property Trust which is in any way different from a trust under a will except that there are no limitations over and the interests of the *cestuis que trust* are represented by transferable and transmissible certificates.

Up to this time we have not alluded to the declaration in the indenture of trust here in question that it was the intention of the parties to it to create a trust and not a partnership. It is what the parties did in making the trust indenture that is decisive. If there had been doubt as to what they did, what they intended to do would have been a matter entitled to some consideration in determining what they did.

It was stated in a passing remark made by this court in *Williams* v. *Johnson*, 208 Mass. 544, 552, that in the trust before the court in that case the certificate holders were partners within the meaning of that word in St. 1909, c. 490, Part I, §27. While that trust provided for meetings of the shareholders and in that respect for some association of and among them, an examination of the original papers shows that it was a trust and not a partnership. This remark was in no way essential to the decision in *Williams* v. *Johnson*.

In the Boston Personal Property Trust the property is the property of the trustees, to be managed for the benefit of the certificate holders, but to be managed by the trustees and not by the certificate holders. There is no association of or among the certificate holders. The rights of the certificate holders are limited to each receiving his share of the income of the trust investments during the continuance of the trust and his share of the corpus of the trust when the trust comes to an end. It is in every respect an investment trust and nothing more.

It follows (1) that the property held by the plaintiffs as trustees of the Boston Personal Property Trust was not taxable as partnership property, and that in the petition brought by them against the city of Boston they are entitled to an abatement; and (2) that their property was taxable as property held in trust the income of which was payable to another, and the taxes assessed by the assessors of the city of Waltham and by the assessors of the Inhabitants of Milton and of Brookline were properly assessed; and that the petitions against those municipalities should be dismissed. It is

So ordered.

BANK OF TOPEKA *v.* EATON.

100 Fed. Rep. 8. 1900.

ON demurrer to declaration.

PUTNAM, Circuit Judge. This is the same case which has already been before us on a plea in abatement, as to which we passed down an opinion and an interlocutory judgment on June 29, 1899. 95 Fed. 355. It now comes before us on demurrer. The declaration is based on a note, as follows: —

"$10,000. Topeka, Kansas, October 24, 1890.

"Sixty days after date the trustee of the Topeka Land and Development Company, as such trustee under declaration of trust dated May 23, 1887, and not otherwise, promise to pay to the order of J. R. Mulvane, president, ten thousand dollars, at Bank of Topeka, Topeka, Kansas, with interest at ten per cent. per annum after maturity until paid; also cost of collecting, including attorney's fees, if suit be instituted on this note. Value received. Appraisement waived. F. R. Cordley, as Trustee as Aforesaid."

The defendants are certificate holders in a joint-stock association, the main purpose of which is dealing in lands in Kansas. The property of the association was vested in three trustees, the survivor of whom gave the note in suit. The articles of association referred to in the note are made a part of the plaintiff's declaration, and contain the following provisions: —

"Said trustees shall have full power and authority, subject to the instructions of the shareholders, as hereinafter provided: (1) To pay all taxes and assessments of every kind legally assessed upon said property, and the necessary expenses of the trust, and for that purpose to borrow money; and any debt for money so borrowed shall be and remain, until paid, a lien upon all funds and moneys belonging to this trust then or thereafter in the hands of the trustees, in preference to the claim of any shareholders as such upon such funds and moneys. . . .

"The trustees shall have no power to bind the shareholders personally, and in every written contract or undertaking they shall enter into relating to this trust, or the property, or any part thereof, belonging thereto, reference shall be made to this declaration of trust, and the person, firm, or corporation so contracting with the trustees shall look only to the funds and property of the trust for payment under such contract or undertaking, or for the payment of any debt, damage, judgment, or decree, or of any money that may become due or payable in any way by reason of the failure on the part of the said trustees to perform such contract or undertaking, in whole or in part; and neither the trustees nor the shareholders, present or future, in the company, shall be personally liable therefor,

or for any debt incurred, or engagement or contract made, by said trustees."

There is nothing further found in the articles of association or in the record with reference to the incurring of liabilities by the trustees in behalf of the association. The declaration, in addition to setting out the articles of association, states merely the facts that the note was given, that the money was advanced therefor, and that the Bank of Topeka received with the note certain securities as collateral for the payment thereof. There is nothing in the declaration showing for what purpose the money was obtained, or to what it was applied. While, therefore, it is not impossible that the trustees might have incurred indebtedness under such circumstances that the law would impose a personal liability on the shareholders, yet, under the allegations found in the declaration, there are no such circumstances; and the plaintiff's case rests entirely upon the authority expressly given the trustees to borrow money for the purposes of the trust. It not only follows that it was the duty of the plaintiff to ascertain for itself what powers the trustees had in the premises, but the specific terms of the note, in that it contains the words, "as such trustee under declaration of trust dated May 23, 1887, and not otherwise," obligated it, by its implied agreement in accepting the note, to abide by the terms of the articles of association. This expression in the note is so positive as to leave no occasion for explanation in support of this proposition, or opportunity for obviating its effect by suggestions made in argument or drawn from decisions on supposed analogous cases. Whether or not the plaintiff examined the articles of association, or knew their contents, is of no consequence, because this express provision required it to do so, or take the hazard of not doing it.

Therefore the only question is whether or not this implied stipulation of the plaintiff, limiting its remedy to the general assets of the association and the property specially pledged to it, is contrary to the rules of law. Of course, a stipulation in an instrument which fundamentally violates its essential nature must sometimes be rejected by the courts. For instance, if any individual or partnership should stipulate in his or its pecuniary obligations that he or it should not be personally liable thereon, without at the same time mortgaging or pledging property, or giving some other specific lien for security, it might be difficult for the law to regard the stipulation, because, in that event, as there would be no lien which the law could enforce, the holder of the obligation would be left without remedy, unless he could proceed by judgment against the obligor; and the result, if sustained, would be an obligation which in law is no obligation. The present case, however, assimilates itself to the large class of cases where, certain property being pledged in some form for the security of a debt, the parties have been at liberty to stipulate that

the owner of the debt should look only to the property thus pledged. In the present case, not only did the Bank of Topeka have specific assets given it for its security, but the entire property of the association was held in trust, and therefore subject to administration by the chancery courts, which could apply it equitably and proportionally to the discharge of obligations incurred by the trustee, as contemplated by the express direction of the articles of association that the debtors of the trust should look for payment solely to its property. Under these circumstances there is no reason why we should not give full effect to the agreement of the Bank of Topeka, arising from its acceptance of the note, that it would be bound by the declaration of trust, including the provisions in the articles exempting the shareholders from personal liability for the engagements of the trustee.

There are some other questions of importance in the case, but our conclusions render it unnecessary to consider them.

Demurrer sustained; declaration adjudged insufficient; judgment for defendants, with costs.

NOTE. — A trustee is liable personally for his acts as trustee, except where he contracts, and stipulates in the contract against personal liability. *Roger Williams Bank* v. *Groton Mfg. Co.*, 16 R.I. 504, and cases there cited.

If a trustee has incurred liability while properly acting as trustee he is entitled to indemnification from the trust property. This is an asset which trust creditors may reach. *In re Raybould*, [1900] 1 Ch. 199.

If the trust property is insufficient for such indemnification, is he entitled, in the absence of any agreement on the matter, to indemnification from the beneficiaries personally? This question was answered in the affirmative by *Hardoon* v. *Belilios*, [1901] A.C. 118, where the beneficiaries were *sui juris* and absolutely entitled to the beneficial interest in the property in question. It is submitted that the principle of this case is sound, at least when applied to beneficiaries who are *sui juris*, and absolutely entitled to shares in the beneficial interest of a fund given to the trustees by the beneficiaries, or their assignors, and which is being employed in business by the trustees for their benefit. This right of indemnification is an asset of the trustee which trust creditors may reach. See *Poland* v. *Beal*, 192 Mass. 559.

It is to be noted that in *Cox* v. *Hickman*, 8 H.L.C. 268, and in *Wells-Stone Co.* v. *Grover*, 7 N.D. 460, creditors of an embarrassed debtor, who consented to the transfer of his business to a trustee and the further prosecution of the business by him, were held not liable at law as partners for the debts incurred by the trustee.

Whether an agreement between the trustee and the beneficiaries

that the trustee should have no right of indemnification against the beneficiaries personally would be valid as against a stranger having a valid claim in tort against the trustee, *quære*.

ELIOT *v.* FREEMAN.

220 U.S. 178. 1911.

MR. JUSTICE DAY delivered the opinion of the court.

These cases present facts differing from those involved in the consideration of the corporation tax cases just decided. *Flint* v. *Stone Tracy Co.*, 220 U.S. 107.

In No. 448 the question is raised as to the right to lay a tax under this statute upon a certain trust formed for the purpose of purchasing, improving, holding and selling lands and buildings in Boston, known as The Cushing Real Estate Trust. By the terms of the trust the property was conveyed to certain trustees, who executed a trust agreement whereby the management of the property was vested in the trustees, who had absolute control and authority over the same, with right to sell for cash or credit, at public or private sale, and with full power to manage the property as they deemed best for the interest of the shareholders. The shareholders are to be paid dividends from time to time from the net income or net proceeds of the property, and twenty years after the termination of lives in being the property to be sold and the proceeds of the sale to be divided among the parties interested. The trustees were to issue 4,800 shares to the owners of the property at $100 each, the owners to receive a number of shares equal to the value of the interest conveyed to the trustees. The shares were transferable on the books of the trustees, and on surrender of the certificate and the transfer thereof in writing a new certificate is to issue to the transferee. No shareholder had any legal title or interest in the property and no right to call for the partition thereof during the continuance of the trust. The legal representatives of a shareholder are to succeed to the interest of a shareholder, the interest passing by operation of law. Provision is made for the termination of the trust by an instrument or instruments in writing, signed by not less than three fourths of the value of stock held by shareholders. Meetings of the shareholders are held at their discretion, or whenever requested in writing by five shareholders, or by shareholders owning not less than one tenth of the shares in value.

The trust has a building, leasing it to a single tenant. It also maintains and operates an office building with elevator service, janitor service, etc.

Case No. 496 involves what is known as a Department Store Trust. It was created by deed and formed for the purpose of purchasing and

holding certain parcels of land in the city of Boston, and erecting a building thereon suitable for a department store. The land and buildings are leased to one tenant for a period of thirty years. The trust had transferable certificates issued to shareholders at the par value of $100 each. The trustees conduct the affairs of the trust, manage the property, and pay dividends when declared. The shareholders meet annually, and a majority of them have the power to elect and depose trustees and to alter and amend the terms of the trust agreement. This trust also continues for certain lives in being and for twenty years thereafter. Each of the trusts involved in these cases is in receipt of a net income exceeding $5000.

Under the terms of the Corporation Tax Law, corporations and joint stock associations must be such as are "now or hereafter organized under the laws of the United States or of any State or Territory of the United States or under the acts of Congress applicable to Alaska or the District of Columbia."

The pertinent question in this connection is: Are these trusts organized under the laws of the State? As we have construed the Corporation Tax Law in the previous cases, *Flint* v. *Stone Tracy Co.*, *supra*, the tax is imposed upon doing business in a corporate or quasi-corporate capacity, that is, with the facility or advantage of corporate organization.

It was the purpose of the act to treat corporations and joint stock companies, similarly organized, in the same way, and assess them upon the facility in doing business which is substantially the same in both forms of organization. Joint stock organizations are not infrequently organized under the statute laws of a State, deriving therefrom, in a large measure, the characteristics of a corporation.

The language of the act ". . . now or hereafter organized under the laws of the United States," etc., imports an organization deriving power from statutory enactment. The statute does not say under the law of the United States, or a State, or lawful in the United States or in any State, but is made applicable to such as are organized under the laws of the United States, etc. The description of the corporation or joint stock association as one organized under the laws of a State at once suggests that they are such as are the creation of statutory law, from which they derive their powers and are qualified to carry on their operations.

A trust of the character of those here involved can hardly be said to be organized, within the ordinary meaning of that term; it certainly is not organized under statutory laws as corporations are. The difference between joint stock associations at common law and those organized under statutes is well recognized (Cook on Corporations, §505): —

"There is an essential difference between a joint stock company as it exists at common law and a joint stock company having exten-

sive statutory powers conferred upon it by the State within which it is organized. The latter kind of joint stock company is found in England and in the State of New York. To such an extent have these statutory powers been conferred on joint stock companies that the only substantial difference between them and corporations is that the members are not exempt from liability as partners for the debts of the company."

The two cases now under consideration embrace trusts which do not derive any benefit from and are not organized under the statutory laws of Massachusetts. Joint stock companies of the statutory character are not known to the laws of that Commonwealth. *Ricker* v. *American L. & T. Co.*, 140 Massachusetts, 346. These trusts do not have perpetual succession, but end with lives in being and twenty years thereafter.

Entertaining the view that it was the intention of Congress to embrace within the corporation tax statute only such corporations and joint stock associations as are organized under some statute, or derive from that source some quality or benefit not existing at the common law, we are of opinion that the real estate trusts involved in these two cases are not within the terms of the act. In that view the decrees in both cases will be reversed and the same remanded to the Circuit Court of the United States for the District of Massachusetts with directions to overrule the demurrers and for further proceedings consistent with this opinion.

Reversed.

B. Where there is some Legislative Enactment.

LIVERPOOL INSURANCE CO. *v.* MASSACHUSETTS.

10 Wall. (U.S.) 566. 1870.

Error to the Supreme Judicial Court of Massachusetts; the case being this: —

A statute of the State just named imposes upon "each fire, marine, and fire and marine insurance company, *incorporated* or *associated* under the laws of any government or State other than one of the United States, a tax of 4 per cent. upon all premiums charged or received on contracts made in this commonwealth for insurance of property." The same statute imposes a tax of but 2 per cent. upon such premiums when the company is incorporated under the laws of any one of the United States other than Massachusetts; upon which premiums, where the company is incorporated by itself, it imposes but 1 per cent.; while no tax is imposed by the laws of the State upon the business of insurances transacted by any natural persons citizens of the same.

The company had been originally formed, in May, 1836, in Liverpool, by a "deed of settlement."

This instrument, as far as it could be done without the aid of Parliament, established a company under the name of "The Liverpool Life and Fire Insurance Company," with a capital of £2,000,000 sterling, which was divided into 100,000 shares of £20 each, and declared its purpose to be making insurance on life and against fire. These shares could be sold and transferred, and executors and administrators represented them in the company on the death of the owner. If, by the laws of the association, a share became forfeited, the owner was released from all further liability to the company. The business of the company was to be conducted by a board of directors *exclusively*, and they could make by-laws and change and modify them. There was a covenant that suits might be brought by or against the company in the names of one or more directors, which should bind the stockholders, and that no stockholder would plead in abatement the nonjoinder of the others; and it was further covenanted that a judgment so obtained against a director might be made out of the property of any of the stockholders. Numerous other provisions were found in the original articles, which consisted of over a hundred sections, but only those are referred to here which bear on the question which the court had before it. There were also three subsequent deeds of settlement, and three acts of Parliament were passed to give efficiency to the purposes of the association.

The first of these acts provided that the association might sue and be sued in the name of the chairman or deputy chairman of the board of directors; that the stockholders might sue the company as plaintiffs, or be sued by it as defendants. It regulated the manner in which *the shareholders might be made individually liable for the debts of the association;* and it declared that the act should *not be construed to incorporate the company or relieve its members from their individual liability*, except as provided in the act.[1]

The second act of Parliament changed the name of the company to that which it now bears, and authorized it to make contracts by the new name, and it also contained a provision that the act should *not make the company a corporation;* and there was a third act which authorized amalgamation with another company, and which again provides *against its being construed into an act of incorporation or a limited liability partnership.*

The Supreme Judicial Court of Massachusetts gave a decree against the company, and enjoined it from the further prosecution of its business till the taxes found to be due were paid.

MR. JUSTICE MILLER delivered the opinion of the court.

The institution now known as the Liverpool and London Life and Fire Insurance Company, doing an immense business in England and in this country, was first organized at Liverpool by what is there called a deed of settlement, and would here be called articles of association.

It will be seen by reference to the powers of the association, as organized under the deed of settlement, legalized and enlarged by the acts of Parliament, that it possesses many, if not all, the attributes generally found in corporations for pecuniary profit which are deemed essential to their corporate character.

[1] Local & Personal Acts, 6 & 7 William IV, CXIX. This act recited that whereas several persons had formed themselves into a company or partnership by the name, etc., and whereas difficulties might arise in recovering the debts due to the company, etc., "since by law all the members for the time being of the said company must be named in every action or suit"; and it was enacted that all proceedings at law or in equity "to be commenced, instituted, or carried on by or on behalf of the said company, or wherein the said company is or shall be concerned or interested, against any person or persons, body or bodies politic or corporate, whether such person or persons, body or bodies politic or corporate, is or are or shall then be a member or members, proprietor or proprietors of or in the said company, or not, shall and lawfully may be commenced, instituted, presented, and prosecuted or carried on in the name of the person who shall be the chairman of the said company . . . as the nominal plaintiff or petitioner for and on behalf of the said company; and all actions, suits, and proceedings in law or in equity to be commenced or instituted against the said company by any person or persons, body or bodies politic or corporate, whether such person or persons, body or bodies politic or corporate, is or are or shall then be a member or members, proprietor or proprietors of or in the said company, or not, shall be commenced, instituted, and prosecuted against the said chairman. . . . " And it was further provided that every judgment against the chairman should "have the like effect and operation upon and against the property and funds of the said company, and upon and against the persons and property of every proprietor thereof, as if all the proprietors of such company were parties before the court to and in such action, suit or proceeding."

1. It has a distinctive and artificial name by which it can make contracts.

2. It has a statutory provision by which it can sue and be sued in the name of one of its officers as the representative of the whole body, which is bound by the judgment rendered in such suit.

3. It has provision for perpetual succession by the transfer and transmission of the shares of its capital stock, whereby new members are introduced in place of those who die or sell out.

4. Its existence as an entity apart from the shareholders is recognized by the act of Parliament which enables it to sue its shareholders and be sued by them.

The subject of the powers, duties, rights, and liabilities of corporations, their essential nature and character, and their relation to the business transactions of the community, have undergone a change in this country within the last half century, the importance of which can hardly be overestimated.

They have entered so extensively into the business of the country, the most important part of which is carried on by them, as banking companies, railroad companies, express companies, telegraph companies, insurance companies, etc., and the demand for the use of corporate powers in combining the capital and the energy required to conduct these large operations is so imperative, that both by statute, and by the tendency of the courts to meet the requirements of these public necessities, the law of corporations has been so modified, liberalized, and enlarged, as to constitute a branch of jurisprudence with a code of its own, due mainly to very recent times. To attempt, therefore, to define a corporation, or limit its powers by the rules which prevailed when they were rarely created for any other than municipal purposes, and generally by royal charter, is impossible in this country and at this time.

Most of the States of the Union have general laws by which persons associating themselves together, as the shareholders in this company have done, become a corporation.

The banking business of the States of the Union is now conducted chiefly by corporations organized under a general law of Congress, and it is believed that in all the States the articles of association of this company would, if adopted with the usual formalities, constitute it a corporation under their general laws, or it would become so by such legislative ratification as is given by the acts of Parliament we have mentioned.

To this view it is objected that the association is nothing but a partnership, because its members are liable individually for the debts of the company. But however the law on this subject may be held in England, it is quite certain that the principle of personal liability of the shareholders attaches to a very large proportion of the corporations of this country, and it is a principle which has warm

advocates for its universal application when the organization is for pecuniary gain.

So also it is said that the fact that there is no provision either in the deed of settlement or the act of Parliament for the company suing or being sued in its artificial name forbids the corporate idea. But we see no real distinction in this respect between an act of Parliament, which authorized suits in the name of the Liverpool and London Fire and Life Insurance Company, and that which authorized suit against that company in the name of its principal officer. If it can contract in the artificial name and sue and be sued in the name of its officers on those contracts, it is in effect the same, for process would have to be served on some such officer even if the suit were in the artificial name.

It is also urged that the several acts of Parliament we have mentioned expressly declare that they shall not be held to constitute the body a corporation.

But whatever may be the effect of such a declaration in the courts of that country, it cannot alter the essential nature of a corporation or prevent the courts of another jurisdiction from inquiring into its true character, whenever that may come in issue. It appears to have been the policy of the English law to attach certain consequences to incorporated bodies, which rendered it desirable that such associations as these should not become technically corporations. Among these, it would seem from the provisions of these acts, is the exemption from individual liability of the shareholder for the contracts of the corporation. Such local policy can have no place here in determining whether an association, whose powers are ascertained and its privileges conferred by law, is an incorporated body.

The question before us is whether an association, such as the one we are considering, in attempting to carry on its business in a manner which requires corporate powers under legislative sanction, can claim, in a jurisdiction foreign to the one which gave those powers, that it is only a partnership of individuals.

We have no hesitation in holding that, as the law of corporations is understood in this country, the association is a corporation, and that the law of Massachusetts, which only permits it to exercise its corporate function in that State on the condition of payment of a specific tax, is no violation of the Federal Constitution or of any treaty protected by said Constitution.

MR. JUSTICE BRADLEY: —

Whilst I agree in the result which the court has reached, I differ from it on the question whether the company is a corporation. I think it is one of those special partnerships which are called joint-stock companies, well known in England for nearly a century, and cannot maintain an action or be sued as a corporation in this country without legislative aid. But as it is a company associated under

the laws of a foreign country, it comes within the scope of the Massachusetts statute, and cannot claim exemption from its operation for the causes alleged in that behalf.

Judgment affirmed.

THOMAS *v.* DAKIN.

22 Wendell (N.Y.) 9. 1839.

BY CHIEF JUSTICE NELSON. This is an action brought by the plaintiff, as president of the Bank of Central New York, an association formed under what is familiarly known as the General Banking Law, passed April 18, 1838, to recover several demands due the institution.

The defendant has demurred to the declaration, and urges the unconstitutionality of the law by way of defence; and it is insisted, in his behalf: 1. That the associations formed under this law are *corporations;* and 2. That a general law authorizing the creation of these bodies, is inconsistent with the ninth section of the seventh article of the constitution. On the part of the plaintiffs, it is urged in reply: 1. That the associations are not corporations; 2. That if they be, the act authorizing them may be passed by a majority *bill;* and 3. If within the ninth section, still the law may be passed by two-thirds of the members elected.

Are these associations corporations? In order to determine this question, we must first ascertain the properties essential to constitute a corporate body, and compare them with those conferred upon the associations; for if they exist in common, or substantially correspond, the answer will be in the affirmative. A corporate body is known to the law by the powers and faculties bestowed upon it, expressly or impliedly, by the charter; the use of the term *corporation* in its creation is of itself unimportant, except as it will imply the possession of these. They may be expressly conferred, and then they denote this legal being as unerringly as if created in general terms. It has been well said by learned expounders, that a corporation aggregate is an artificial body of men, composed of divers individuals, the *ligaments of which body are the franchises and liberties bestowed upon it,* which bind and unite all into one, and in which consists the whole frame and essence of the corporation. The "franchises and liberties," or, in more modern language, and as more strictly applicable to private corporations, the *powers and faculties*, which are usually specified as creating corporate existence, are: 1. The capacity of perpetual succession; 2. The power to sue and be sued, and to grant and receive in its corporate name; 3. To purchase and hold real and personal estate; 4. To have a common seal; and 5. To make by-laws. These *indicia* were given by judges and elementary writers at a very early

day: since which time the institutions have greatly multiplied, their practical operation and use have been thoroughly tested, and their peculiar and essential properties much better understood. Any one comprehending the scope and purpose of them, at this day, will not fail to perceive that some of the powers above specified are of trifling importance, while others are wholly unessential. For instance, the power to purchase and hold real estate is no otherwise essential than to afford a place of business; and the right to use a *common seal*, or to *make by-laws*, may be dispensed with altogether. For as to the one, it is now well settled that corporations may contract by resolution, or through agents, without seal; and as to the other, the power is unnecessary, in all cases where the charter sufficiently provides for the government of the body. The distinguishing feature, far above all others, is the capacity conferred, by which *a perpetual succession of different persons shall be regarded in the law as one and the same body, and may at all times act in fulfillment of the objects of the association as a single individual.* In this way, a legal existence, a body corporate, an artificial being, is constituted; the creation of which enables any number of persons to be concerned in accomplishing a particular object, as one man. While the aggregate means and influence of all are wielded in effecting it, the operation is conducted with the simplicity and individuality of a natural person. In this consists the essence and great value of these institutions. Hence it is apparent that the only properties that can be regarded strictly as essential, are those which are indispensable to mould the different persons into this artificial being, and thereby enable it to act in the way above stated. When once constituted, this legal being created, the powers and faculties that may be conferred are various — limited or enlarged, at the discretion of the legislature, and will depend upon the nature and object of the institution, which is as competent as a natural person to receive and enjoy them. We may, in short, conclude by saying, with the most approved authorities at this day, that the essence of a corporation consists in a capacity: 1. To have perpetual succession under a special name, and in an artificial form; 2. To take and grant property, contract obligations, sue and be sued by its corporate name as an individual; and 3. To receive and enjoy in common, grants of privileges and immunities.

We will now endeavor to ascertain with exactness the powers and attributes conferred upon these associations by virtue of the statute. The first fourteen sections (1 to 14) prescribe the duties of the comptroller in furnishing notes for circulation, taking the required securities, etc. The 15th provides, that any number of persons may associate to establish offices of discount, deposit and circulation. The 16th, that they shall make and file a certificate, specifying: 1. The *name* to be used in the business; 2. The *place* where the business shall be carried on; 3. The *amount* of capital stock, and number of

shares into which divided; 4. The *names of the shareholders;* 5. The *duration* of the association. The 18th confers upon the persons thus associating, the most ample powers for carrying on banking operations, together with the right "to exercise such incidental powers as shall be necessary to carry on such business"; also to choose a president, vice president, cashier, and such other officers and agents as may be necessary. By the 21st and 22d sections, contracts, notes, bills, etc., shall be signed by the president and cashier; and all suits, actions, etc., are to be brought in the name of, and also against the president for the time being; and not to abate by his *death, resignation* or *removal*, but to be continued in the name of the successor. 24th section: The association may purchase and hold real estate, etc., the conveyance to be made to the president, or such other officer as shall be designated, who may sell and convey the same free from any claim against shareholders. 19th section: The shares of capital stock to be deemed personal property, transferable on the books of the association; and every person becoming a shareholder by such transfer, shall succeed to all the rights and liabilities of the prior holder. 23d section: No shareholder to be personally liable; and the association is not to be dissolved by the *death* or *insanity* of any shareholder.

1. Upon a perusal of these provisions, it will appear that the association acquires the power to raise and hold for common use any given amount of capital stock for banking purposes, which, when subscribed, is made personal property, and the several shares transferable the same and with like effect as in case of corporate stock; to assume a common name under which to manage all the affairs of the association; to choose all officers and agents that may be necessary for the purpose, and remove and appoint them at pleasure. It will hence be seen, that although the association may be composed of a number of different persons, holding an interest in the capital stock, its operations are so arranged that they do not appear in conducting its affairs; all are so bound together, so moulded into one, as to constitute but a single body, represented by a common name, or names (the knot of the combination), and in which all the business of the institution is conducted by common agents. In this way it purchases and holds real and personal property, contracts obligations, discounts bills, notes and other evidences of debt, receives deposits, buys gold and silver bullion, bills of exchange, etc., loans money, sues and is sued, etc. It is true, some portion of the business is conducted in the assumed name, and some in the name of the president for the time being; but this in no manner changes the character of the body. A corporation may have more than one name; it may have one in which to contract, grant, etc., and another in which to sue and be sued; so it may be known by two different names, and may sue and be sued in either; and the name of the president, his

official name, or any other, will answer every purpose. 2 Bacon's Abr. 5. 2 Salk. 451. 2 *id.* 237. Ld. Raym. 153, 680. The only material circumstance is, a name, or names, of some kind, in which all the affairs of the company may be conducted. So much, and no more, is essential to give simplicity and effect to the operation. An artificial being is thus plainly created, capable of receiving all the ample powers and privileges conferred upon the associations, and of managing their diversified concerns in an individual capacity. All business is to be conducted in a common or proper name.

2. This artificial being possesses the powers of perpetual succession. Neither *sale* of shares, or *death* of shareholders affect it; if one should sell his interest, or die, the purchaser or representative, by operation of law, immediately takes his place. § 19. Nor can the insanity of a member work a dissolution. *Id.* Officers and agents for conducting the business of the association are secured. In case of vacancy, by death or otherwise, the place may at once be filled. § 18. For the entire duration, therefore, of the association, and which may be without limit, § 16, *sub.* 5, the whole body of shareholders, though perpetually shifting, constitute the same uniform, artificial being which is to be engaged through the instrumentality of officers and agents in conducting the business of the concern, and no member is personally liable. § 23. Then, as to the powers conferred, without again specially recurring to them, it will be seen at once that the associations possess all that are deemed essential, according to the most approved authorities, to constitute a corporate body. They have a capacity: 1. To have perpetual succession under a common name, and in an artificial form; 2. To take and grant property, contract obligations, to sue and be sued by its corporate name, in the same manner as an individual; 3. To receive grants of privileges and immunities, and to enjoy them in common. All these are expressly granted, and many more, besides the general sweeping clause, "*to exercise such incidental powers as shall be necessary to carry on such business*" (meaning the business of banking), under which even the seal and right to make by-laws are clearly embraced, if essential in conducting the affairs of the institution.

[A majority of the court was of opinion that, on the record, it must be taken that the general banking law, although providing for the creation of corporations, had been passed in conformity with the provisions of the constitution, and judgment was given for the plaintiff.]

PEOPLE *v.* COLEMAN.

133 N.Y. 279. 1892.

APPEAL from order of the General Term of the Supreme Court, in the first judicial department, made February 13, 1891, which affirmed a judgment in favor of plaintiff, entered upon a decision of the court on trial at Special Term, vacating an assessment.

This was a proceeding by certiorari to review the action of the commissioners of taxes and assessments of the city of New York, in imposing an assessment upon the capital stock of the National Express Company, a joint-stock company, of which the relator is treasurer, for the year 1888.

FINCH, J. The relator was taxed upon its capital on the ground that it had become a corporation within the meaning of the provision of the Revised Statutes which enacts that "all monied or stock corporations deriving an income or profit from their capital or otherwise, shall be liable to taxation on their capital in the manner hereinafter prescribed." (1 R.S. title 4, chap. 13, part 1.) The company was formed as a joint-stock company or association in 1853 by a written agreement of eight individuals with each other, the whole force and effect of which, in constituting and creating the organization, rested upon the common-law rights of the individuals and their power to contract with each other. The relation they assumed was wholly the product of their mutual agreement and dependent in no respect upon the grant or authority of the state. It was entered into under no statutory license or permission, neither accepting nor designed to accept any franchise from the sovereign, but founded wholly upon the individual rights of the associates to join their capital and enterprise in a relation similar to that of a partnership. A few years earlier the legislature had explicitly recognized the existence and validity of such organizations, founded upon contract and evolved from the common-law rights of the citizens. (Laws of 1849, chap. 258.) That act provided that any joint-stock company or association, which consisted of seven or more members, might sue or be sued in the name of its president or treasurer, and with the same force and effect, so far as the joint property and rights were concerned, as if the suit should be prosecuted in the names of the associates. But the act explicitly disclaimed any purpose of converting the joint-stock associations recognized as existing, into corporations by a section prohibiting any such construction. (§ 5.) In 1851 the act was amended in its form and application, but in no respect material to the present inquiry. There is no doubt, therefore, that when the company was formed and went into operation the law recognized a distinction and substantial difference between joint-stock companies and corporations and never confused one with the other, and that

the existing statute which taxed the capital of corporations had no reference to or operation upon joint-stock companies or associations.

But two things have since occurred. The legislature, while steadily preserving the distinction of names, has with equal persistence confused the things by obliterating substantial and characteristic marks of difference, until it is now claimed that the joint-stock associations have grown into and become corporations by force of the continued bestowal upon them of corporate attributes. It is said, and very probably correctly said, that the legislature may create a corporation, without explicitly declaring it to be such, by the bestowal of a corporate franchise or corporate attributes, and the cases of banking associations are referred to as instances of actual occurrence. (*Thomas* v. *Dakin*, 22 Wend. 9; *Bank of Watertown* v. *Watertown*, 25 id. 686; *People* v. *Niagara*, 4 Hill, 20.) It is added that such result may happen even without the legislative intent, and because the gift of corporate powers and attributes is tantamount to a corporate creation. It is then asserted that a series of statutes, beginning with the act of 1849, has ended in the gift to joint-stock associations of every essential attribute possessed by and characteristic of corporations (Laws of 1853, chap. 153, Laws of 1854, chap. 245, Laws of 1867, chap. 289); that the lines of distinction between the two, however far apart in the beginning, have steadily converged until they have melted into each other and become identical; that every distinguishing mark and characteristic has been obliterated, and no reason remains why joint-stock associations should not be in all respects treated and regarded as corporations.

Some of this contention is true. The case of *People ex rel. Platt* v. *Wemple*, 117 N.Y. 136, shows very forcibly how almost the full measure of corporate attributes has, by legislative enactment, been bestowed upon joint-stock associations, until the difference, if there be one, is obscure, elusive and difficult to see and describe. And yet the truth remains that all along the line of legislation the distinctive names have been retained as indicative and representative of a difference in the organizations themselves. As recently as the acts of 1880 and 1881, which formed the subject of consideration in the *Wemple* case, the legislature, dealing with the subject of taxation and desiring to tax business and franchises, imposed the liability upon "every corporation, joint-stock company or association whatever now or hereafter incorporated or organized under any law of this state." It is significant that the words "or organized" were inserted by amendment, and evidently for the understood reason that joint-stock companies could not properly be said to be "incorporated," but might be correctly described as "organized" under the laws of the state. This persistent distinction in the language of the statutes I should not be inclined to disregard or treat as of no practical consequence, when seeking to arrive at the true intent and proper

construction of the statute, even if I were unable to discover any practical or substantial difference between the two classes of organizations upon which it could rest, or out of which it grew, for the distinction so sedulously and persistently observed would strongly indicate the legislative intent, and so the correct construction.

But I think there was an original and inherent difference between the corporate and joint-stock companies known to our law which legislation has somewhat obscured, but has not destroyed, and that difference is the one pointed out by the learned counsel for the respondent, and which impresses me as logical and well supported by authority. It is that the creation of the corporation merges in the artificial body and drowns in it the individual rights and liabilities of the members, while the organization of a joint-stock company leaves the individual rights and liabilities unimpaired and in full force. The idea was expressed in *Supervisors of Niagara* v. *People*, 7 Hill, 512, and in *Gifford* v. *Livingston*, 2 Den. 380, by the statement that the corporators lost their individuality and merged their individual characters into one artificial existence; and upon these authorities a corporation is defined on behalf of the respondents to be "an artificial person created by the sovereign from natural persons and in which artificial person the natural persons of which it is composed become merged and non-existent." I am conscious that legal definitions invite and provoke criticism, because the instances are rare in which they prove to be perfectly accurate; and yet this one offered to us may be accepted if it successfully bears some sufficient test. In putting it on trial we may take the nature of the individual liability of the corporators on the one hand and of the associates on the other, for the debts contracted by their respective organizations, as a sufficient test of the difference between them, and contrast their nature and character.

It is an essential and inherent characteristic of a corporation that it alone is primarily liable for its debts, because it alone contracts them, except as that natural and necessary consequence of its creation is modified in the act of its creation by some explicit command of the statute which either imposes an express liability upon the corporators in the nature of a penalty, or affirmatively retains and preserves what would have been the common-law liability of the members from the destruction involved in the corporate creation. In other words, the individual liability of the members, as it would have existed at common law, is lost by their creation into a corporation, and exists thereafter only by force of the statute, upon some new and modifying conditions, to some partial or changed extent, and so far preventing, by the intervention of an express command, the total destruction of individual liabilities which otherwise would flow from the inherent effect of the corporate creation. The penalties sometimes imposed are of course new statutory liabilities which never

at common law rested upon the individual members. The retained liability occasionally established is in the nature and a parcel of such original liability, as we had occasion to show in *Rogers* v. *Decker*, 131 N.Y. 490, but is retained by force of the express command of the statute and in that manner saved from the destruction which otherwise would follow the simple creation of the corporation. Ordinarily, these individual liabilities exist upon other than common-law conditions, and make the corporators rather sureties or guarantors of the corporation than original debtors, since in general their liability arises after the usual remedies against the corporation have been exhausted. But where that is not so, the invariable truth is that the creation of the corporation necessarily destroys the common-law liability of the individual members for its debts, and requires at the hands of the creating power an affirmative imposition of new personal liabilities or a specific retention of old ones from the destruction which would otherwise follow. Exactly the opposite is true of joint-stock companies. Their formation destroys no part or portion of their common-law liability for the debts contracted. Those debts are their debts for which they must answer. Permission to sue their president or treasurer is only a convenient mode of enforcing that liability, but in no manner creates or saves it. The statute of 1853 did interfere with it. That act required in the first instance a suit against the president or treasurer, and so a preliminary exhaustion of the joint property. But that act was modal, and determined the procedure. It suspended the common-law right, but recognized its existence. We so held in *Witherhead* v. *Allen*, 4 Abb. Ct. App. Dec. 628, and at the same time said that the associations were not corporations but mere partnership concerns. Even that mode of procedure has been modified by the Code (§§ 1922, 1923), so that the creditor at his option may sue the associates without bringing his action against the president or treasurer. These last and quite recent enactments show that the legislative intent is still to preserve and not destroy the original difference between the two classes of organizations; to maintain in full force the common-law liability of associates and not to substitute for it that of corporators; and, preserving in continued operation that normal and distinctive difference, to evince a plain purpose not to merge the two organizations in one or destroy the boundaries which separate them. That intent, once clearly ascertained, determines the construction to be adopted, and may be the only reliable test in view of the power of the state to clothe one organization with all the attributes of the other. The drift of legislation has been to lessen and obscure the original and characteristic difference. On the one hand corporations have been created with positive provisions retaining more or less the individual liability of the members, and on the other the joint-stock companies have been clothed with most of the corporate attributes, but enough

of the original difference remains to show that our legislation not only carefully preserves the distinction of names, but sufficient, also, of the original difference of character and quality to disclose a clear intent not to merge the two.

We may thus see upon what the legislative intent to preserve them as separate and distinct is founded and what distinguishing characteristics remain. The formation of the one involves the merging and destruction of the common-law liability of the members for the debts, and requires the substitution of a new or retention of the old liability by an affirmative enactment which avoids the inherent effect of the corporate creation; in the other, the common-law liability remains unchanged and unimpaired and needing no statutory intervention to preserve or restore it; the debt of the corporation is its debt and not that of its members, the debt of the joint-stock company is the debt of the associates however enforced; the creation of the corporation merges and drowns the liability of its corporators, the creation of the stock company leaves unharmed and unchanged the liability of the associates; the one derives its existence from the contract of individuals, the other from the sovereignty of the state. The two are alike but not the same. More or less, they crowd upon and overlap each other, but without losing their identity, and so, while we cannot say that the joint-stock company is a corporation, we can say as we did say in *Van Aernam* v. *Bleistein* (102 N.Y. 360), that a joint-stock company is a partnership with some of the powers of a corporation. Beyond that we do not think it is our duty to go.

The order should be affirmed, with costs. All concur.

Order affirmed.

HIBBS *v.* BROWN.

190 N.Y. 167. 1907.

THE appellant owned a certain bond, with coupons attached, of the Adams Express Company, which was stolen from him and sold to the respondents. The respondents claimed that they were protected, because they were *bona fide* purchasers of negotiable instruments. The appellant denied that the bond was negotiable.

The Adams Express Company was an unincorporated voluntary association or joint-stock association organized under the laws of New York for the purpose of carrying on an express business, and having a president and other officers, and issuing certificates of stock which represented and whereby were transferred the rights of the respective shareholders.

The bond was issued by the express company in and under its association name, and was one of an issue of twelve millions of dollars, secured by a certain trust indenture conveying and pledging

for its payment a large amount of securities and property. The bond provided that "no present or future shareholder, officer, manager or trustee of the Express Company shall be personally liable as partner or otherwise in respect to this bond or the coupons pertaining thereto, but the same shall be payable solely out of the assets assigned and transferred to the said Trust Company [the trustee for the bondholders] or out of other assets of the Express Company."

Hiscock, J. The Negotiable Instruments Law (L. 1897, ch. 612), section 20, provides that "An instrument to be negotiable must conform to the following requirements: . . .

"2. Must contain an unconditional promise or order to pay a sum certain in money."

Section 22 of the same statute describes an unconditional promise to pay as follows: "An unqualified order or promise to pay is unconditional within the meaning of this act, though coupled with:

"1. An indication of a particular fund out of which reimbursement is to be made, or a particular account to be indebted with the amount, or

"2. A statement of the transaction which gives rise to the instrument.

"But an order or promise to pay out of a particular fund is not unconditional."

It is not claimed that payment of these bonds is limited to the property pledged as security therefor with the trustee, but it is admitted that they may be collected from any and all of the general assets and property of the express company. The only respect in which they are claimed to come in conflict with the prohibition against a negotiable instrument being payable "out of a particular fund," is because of the provision that they may not be collected from the individual property of the members of the association. This subtraction, it is said, makes the remaining property from which they be collected a "particular fund."

The decisions which I have quoted state the rule that a negotiable instrument may not be made payable out of a particular fund as the equivalent of the one that it must be "drawn on the general credit of the drawer," and so if we fairly can say that, notwithstanding the exemption, the maker of the bonds did pledge its general credit, then it will follow that there has not been that limitation of promise of payment to a particular fund which is prohibited by the statute.

Was the general credit of the obligor pledged?

The Adams Express Company was the maker of the bonds. They were issued by it in its artificial, corporate-appearing name, under its common seal, by its authorized executive officers and for its benefit. They expressed the general promise and obligation of the company which thus issued them, and were a claim against it upon which, as we shall see hereafter, judgment might be obtained or a

receiver be appointed of it, and satisfaction obtained out of any or all of its joint, business, well-understood assets and property, and which we know aggregated many millions of dollars. Payment was not limited to the pledged securities or to any other part or parcel of the property of the association which made the bonds, but was a charge against the whole thereof. Thus far, therefore, they were entirely similar to the familiar bonds issued by an ordinary corporation which are general claims against it, and which are concededly negotiable. But here it is that we come against the contention that this view of the character of the bonds however practical and desirable cannot prevail; that the exemption of the personal liability of the individual members of the association after all works a limitation upon the pledging of the general credit of the company which issued the bonds, and turns all of its assets, from which their payment may be enforced, into a special, limited fund.

As the foundation for this contention much care has been devoted to pointing out the difference between a joint-stock association and a corporation, and to emphasizing the fact that the former is in effect a partnership, and that the individual liability of its members is just as essential a characteristic as it is in the case of a partnership, and that, therefore, it may not be eliminated without materially affecting the contract of the association.

Of course there can be no doubt that a joint-stock association differs from a corporation, or that in its original conception and ultimate analysis it is like a partnership in respect to the individual liability of its members. But, upon the other hand, so many of the attributes and characteristics of a corporation have been impressed upon the modern joint-stock association that in my opinion, for the purposes of the question now before us, we are amply justified in regarding simply the joint, *quasi* corporate, entity, and in saying that an obligation issued in its name upon its general credit, and binding all of its assets, complies with the requirements for a negotiable instrument, even though the practically unimportant individual liability of members is excluded.

We may briefly refer to some of these characteristics which, as I think, have led both courts and laymen to regard joint-stock associations largely as corporate creations, and in ordinary business dealings quite to ignore the feature of individual membership and liability, even though it does exist. They are, like corporations, organized under and regulated by statutes (Laws 1894, chapter 235). They have, and transact business under, an artificial name. Their capital and ownership is represented by shares of stock transferable at will, and their existence is not dissolved or affected by the death of or transfer of interest by members. They have regular officers in whose names actions may be commenced in behalf of and against the association, and upon a judgment rendered in the latter case, execu-

tion may be issued only against property belonging to the association or to all of its members jointly. Formerly action could not be brought against the individual members of the association until after judgment and execution unsatisfied against the association. Now, although an action may be brought in the first instance against the members, still if the claimant elects to bring suit against the association he must then as formerly proceed to judgment and execution unsatisfied before instituting other suit against the members. And, as illustrating the complete and separate existence of the association as between it and the individual members, suit may be brought by it against such members. (Code, §§ 1919–1924.)

Now, while it is true that these statutes conferring upon joint-stock associations the attributes of corporations, and the opinions discussing the similitude of the former to the latter do not destroy the element of individual liability, they do irresistibly force upon us appreciation of the fact that a great association like the Adams Express Company is very unlike an ordinary copartnership and that it has assumed for ordinary, practical purposes in its business and contractual relations the features and characteristics of a corporate creation, whereby the joint aggregate entity has been made prominent, and the individual units composing it have been overshadowed and obscured. Amongst other things, as we have seen, this organization in its aggregate capacity and under its artificial name which bears no relation to the identity of its members, may not only hold property, transact business and make contracts, but, what is especially pertinent in this controversy, those contracts may be enforced by proceedings against it which are entirely independent of any liability of individual members. In short, I do not think that we should transgress any proper limits, if we assumed that the public in dealing with the present bonds did so solely upon the faith and credit of the association, the entity which issued them, and without knowledge or thought of the individuals who composed it or their financial responsibility.

Under such circumstances we ought not to sacrifice substance to form and destroy the negotiable character of the bonds because of the exemption of individual liability unless we are compelled to, either by some controlling principle or authority, and, as I believe, there is neither which commands such a course.

The rule defining the requisites of negotiable instruments though now embodied in a statute is subject to a reasonable interpretation and construction. While we may not disregard the requirement that such an instrument must not be limited for payment to a particular fund, we may say what facts satisfy this requirement. We cannot, of course, override the terms of a statute when finally interpreted. But we can refrain from giving to those provisions too literal or impractical an interpretation which will work unexpected and undesirable

results. We must accept the full test laid down at the commencement, that these bonds must not be made payable out of a particular fund or be issued otherwise than upon the general credit of the maker. But upon the proofs presented in my judgment we are not compelled to say that they are not general charges against the obligor which issued them as fairly and practically created, regulated and regarded, or that being a claim against all of its assets they are payable out of a particular fund. I think that the authorities which have been cited to sustain the contention that they are vulnerable in these respects, not only do not do so, but that a careful consideration of them and of other authorities in the light of the facts under consideration in each case, discloses that none of them has held an instrument to be payable out of a particular fund and hence non-negotiable upon any such proofs as appear here. In every case it will be seen that the instrument which was condemned was simply an order upon or assignment of some specific, limited fund or interest and carried no general liability of the drawer which made it a charge against his general credit and all of his assets. Under such circumstances it was held to be an assignment *pro tanto* and, of course, as an assignment it was not negotiable.

O'BRIEN, J. The only question in this case is whether the coupons which are the subject-matter of the action are upon their face negotiable instruments. I think they are, and my reasons for this conclusion stated as briefly as may be are these: It is admitted that the coupons are a part of and impressed with the same legal character as the bonds themselves from which they were detached. If the bonds are negotiable, so are the coupons. I do not understand that it is seriously claimed that the fact that a fund was set apart and conveyed to a trustee to assure the payment of the bonds as they fell due affected the legal character of these obligations as negotiable instruments so long as the holders were not confined or limited to that fund for payment. It is, I assume, a very common practice in the modern business world to set aside a fund or to provide for the creation of a sinking fund for the ultimate payment or redemption of bonds, but it was never supposed that this fact would affect their negotiable character. The very purpose of such financial arrangements is to give greater assurance of payment to those who purchase the bonds in the market by adding to their value and credit. The fund is a protection to the holders of the bonds and in some cases to others who may become liable for their payment in whole or in part. In this case not only the fund set apart, but all the other assets of the company as well, were pledged for the payment of the bonds, and, hence, the fund only added to their credit and financial value without affecting in the least their negotiable character.

The only question in the case as to which there is any serious dispute is, as I conceive, whether the clause on the face of the bonds

which provides that "no present or future shareholder, officer, manager or trustee of the Express Company shall be personally liable as partner or otherwise in respect of these bonds or the coupons appertaining thereto" deprives them of the character of negotiable paper. The contention of the plaintiff is that this clause destroys the negotiable quality of the bonds though payable to the bearer or holder. This clause contains also the statement that the bonds "shall be paid solely out of the assets assigned and transferred to the said trust company or out of the other assets of the Express Company." So that all the property of the company issuing the bonds was and is available to the holders as the source of payment and satisfaction thereof. I do not think that the obligations of a joint-stock company payable to bearer are rendered non-negotiable from the fact that the paper upon its face contains a clause which exempts the shareholders and officers from liability so long as the general assets of the company are pledged for payment. But this is the disputed question in the case, and the contrary view is supported by an argument which rests mainly, if not entirely, upon the proposition that joint-stock associations are partnerships, and that the obligations in question are the obligations of the individual shareholders, and that they are liable upon them, jointly and severally, the same as partners. Stating the argument in another way it comes to this: The bonds in this case are the bonds of a partnership, made in the name of the firm, and though containing a promise to pay the bearer or holder a specified sum of money in the future, upon a day certain, yet the promise is coupled with a condition that none of the partners shall ever be held liable. If the premises upon which the argument is based are correct, it would, I admit, be difficult to resist the conclusion, unless, indeed, it could be held that the conditions might be rejected as utterly inconsistent with and repugnant to the promise and, therefore, void. Adopting the theory that the bonds are the obligations of the shareholders as partners, the repugnancy is quite obvious. But I do not think that the bonds in question are in any proper or legal sense partnership obligations made by the shareholders as partners. Primarily the promise to pay the bearer or holder is not the promise of the shareholders, but of the legal entity represented by the express company as such.

A joint-stock company, whatever else may be said about it, is certainly for most, if not all practical purposes, a legal entity, capable in law of acting and assuming legal obligations quite independent of the shareholders. The idea that these companies occupy some undefined and undefinable ground midway between a partnership and a corporation has practically faded away and cannot be applied to the question with which we are now concerned. It is not very important to inquire what they were in their origin, but rather what they are now, or at least were when the bonds in question were issued

and sold to the public. It seems to be conceded or assumed that if the express company, at the time of issuing the bonds, had been incorporated by filing the usual certificate for that purpose, the clause exempting the shareholders from liability would not affect their negotiable character. It remains only to consider what sound distinction, if any, can be made between the twelve millions of bonds issued by the express company and the other untold millions of other bonds issued by corporations. They are all negotiable in form, that is to say, payable to order or bearer, as the case may be. Assuming that the shareholders of a corporation are or may be liable for the corporate debts, and that the clause referred to would not affect the negotiable quality of its paper, what reason is there for holding that the clause destroys the negotiable quality of the bonds in question? The proposition that in the one case the bonds import a promise to pay by a corporate body and in the other the promise of individuals as partners or as a partnership firm, does not seem to me to be reasonable or tenable. The argument in support of that theory would seem to be somewhat strained. The general rules of law that govern partnerships have very little application to joint-stock companies, at least so far as concerns the question now under consideration. The principle of agency which enables one partner to bind all his associates as well as the firm has no application to such companies. The death of one or more of the members of the company does not work a dissolution. The doctrine of survivorship, so important as between partners, does not exist as to such companies, and so it would be difficult to state a single general rule of partnership law that in its full extent could be applied to such companies. On the other hand, there are very few of the legal principles that apply to corporations that do not apply in some form to these companies. They are taxed and perpetuated through the shares of stock as corporations are. They are entitled to assume an artificial name, to sue and are subject to be sued. They may use a common seal and through the shares of stock they have perpetual life even in a larger sense than corporations have. Their general powers and duties to the public are practically the same and regulated in the same way as corporations. I need not pursue the comparison any further, nor enlarge upon it, since the learned opinion of my associate, Judge Hiscock, who has referred to the various judicial views on the subject, pro and con, fully covers that feature of the case.

It is very true that the shareholders of such companies are liable ultimately for the company's obligations, but that does not make such companies partnerships in the sense that their obligations are the contracts or promises of the shareholders. The shareholders of corporations are or may be liable in the same way, but such liability is not, of course, that of partners. The statutes of this state prescribing the method of procedure in suits by and against joint-stock

companies (Code Civ. Proc. §§ 1919 to 1924) do not qualify what has been stated concerning the legal nature of such companies. They embody the distinct idea that the liability of the shareholders is not primary, but secondary, the same as in case of corporations; and even if these statutes had never been enacted it is quite likely that the Adams Express Company could, in that artificial name, sue and be sued in the same manner as a corporation, since the State Constitution (Art. 8, § 3), while enacting that corporations have the right to sue and are subject to be sued the same as natural persons, defines joint-stock companies having any of the powers and privileges not possessed by individuals or partnerships as corporations within the meaning of that section. The main purpose of these provisions of the Code would seem to be the enactment of a mode of procedure which would enable creditors of the company, or parties having a cause of action against it, to exhaust all legal remedies against the company as a legal entity before resorting to the personal liability of the shareholders analogous to similar rules applicable to corporations. It is, I think, very difficult to avoid the conclusion that these companies at this day and in this state possess substantially and practically all the attributes of corporations, and still more difficult to assign any sound reason for any distinction to be made between the negotiable character of the bonds of each when made payable to bearer. These companies are for all practical purposes *quasi* corporations, and it seems to me are clearly such so far as concerns the negotiable character of its commercial paper or promise to pay a specific sum of money to bearer upon a day certain.

If the bonds in their present form had been stolen from the Adams Express Company by one of its clerks or employees, or even a stranger, and they had been put in circulation and passed from hand to hand to the possession of an innocent holder who had purchased them in the market in good faith and for value, and the company had brought suit against him to recover the stolen property, as the plaintiff in this case has, we would then have the same question before us that we have now. It may be safely asserted that under such circumstances the company would and ought to fail in the action, and that it would not be permitted to impeach the holder's title to the paper by the fact that upon its face there was a condition discharging the shareholders from liability, and, hence, were not negotiable instruments. When the important powers and functions which these companies possess and exercise in the business and commercial world are considered, the close analogy between corporations and joint-stock companies is made still more evident. They are not only common carriers of property with world-wide connections and ramifications, but deal in money credits and exchanges in practically the same way as banks. They purchase and deliver goods upon the order of local customers in all parts of the country and even in foreign

countries. They have issued millions of securities in the form of bonds payable to bearer that have been sold to the public. It seems to me that it would be at least unwise to discredit these securities by holding that in consequence of the exemption clause as to the shareholders' liability the bonds are mere contracts to pay without the quality of negotiability. Such a result, I think, would not be sanctioned by sound policy or sound law and would be contrary to the intention of every one connected with the transaction either as maker or buyer, since it cannot be supposed that a business man of any sense would have offered to sell in the market, and much less to buy, a partnership obligation payable to bearer with a condition clause upon its face releasing all the partners from any obligation to pay it.

So far as concerns the question involved in this appeal, the bonds, I think, are not the bonds of the several members of the company as partners, but of a legal entity as such, with an artificial name analogous to a corporation, and they possess all the qualities of corporate bonds payable to bearer. It is quite obvious that in respect to the negotiable quality of the bonds they must be considered and treated in law either as partnership or as corporate obligations. There is no middle ground upon which to rest. The argument that the promise to pay is that of a partnership does not seem to me to be supported by any conclusive reasons, and if adopted might destroy a large class of securities held by innocent investors. The general rule, which I fully recognize, no doubt is that in order to give to commercial paper, whether in the form of bonds or promissory notes, the quality of negotiability, and the legal rights which appertain to such instruments, the promise to pay must be unconditional and all the assets of the promisor or maker must be pledged to make good the promise according to its terms. The bonds in question, in my opinion, comply with that rule, unless it can be held that the liability of the shareholders of the company can be called assets within the meaning of the rule and I think it cannot. The assets of the express company, the maker of the bonds in question, consisted of its actual, tangible property over which it had full power of disposition, dominion and control, and not the liability which the law imposes upon shareholders for the company debts in certain cases and upon certain contingencies. There is no reason that I can perceive for denying to a *bona fide* holder of one of these bonds any means of defending his title when attacked that the law gives to a like holder of the negotiable paper of an individual or corporation.

WERNER, J. Although I concur in the result of the decision about to be made, I cannot yield assent to the reasoning upon which it is based. The vital question in this case is whether the bonds from which the coupons in suit were clipped are negotiable instruments or not, and that depends upon several considerations which I will briefly discuss.

These bonds are part of an issue of $12,000,000 made by the Adams Express Company, which is a joint-stock association, each of whose shareholders is, by the terms of its articles of association and the general law, individually liable for the debts of the company incurred in the transaction of its business. The bonds are made in the name of the company, are payable to bearer, and contain many if not all the stipulations and conditions that are usually found in corporate bonds such as are now concededly in the category of negotiable instruments. (*Mercer County* v. *Hacket*, 1 Wall. 83, and cases there cited.) These bonds also contain another clause that is not to be found in corporate bonds. They recite that, "No present or future shareholder, officer, manager or trustee of the express company shall be personally liable as partner or otherwise in respect of this bond or the coupons appertaining thereto, but the same shall be payable solely out of the assets assigned and transferred to the said trust company (the trustee named in the trust deed), or out of the other assets of the express company." As this clause is in direct conflict with the general provisions of the law and the express company's articles of association respecting the individual liability of the shareholders of the company, the real question in the case is whether the particular clause is a valid and essential part of the bonds, or whether it can be eliminated as repugnant to the general tenor and purpose of the instruments in which it is found. If the clause is valid there can scarcely be any logical escape from the conclusion that the bonds are rendered non-negotiable. If, however, the particular clause can be discarded as void, that will eliminate the only difference of substance between these bonds and other bonds which, by common consent, are classed as negotiable instruments.

The reason why the last quoted clause of the bonds, if valid, is inconsistent with their negotiability is that they are the obligations of a joint-stock association as distinguished from a corporation, and the stipulation absolving the shareholders of the company from individual liability is a distinct limitation upon the credit which is pledged in the making of the instrument. One of the cardinal qualities of a negotiable instrument is that it must pledge the general credit of the maker. This was one of the universally recognized rules of the law merchant as declared in the English decisions. (*Dawkes* v. *De Lorane*, 3 Wils. 207; *In re Boyse*, L.R. [33 Ch. Div.] 612; *Bank of England* v. *Vagliano*, L.R. [App. Cas. 1891] 107–145; *M'Lean* v. *Clydesdale Co.*, L.R. [9 App. Cas.] 95); and in the decisions of this state. (*Munger* v. *Shannon*, 61 N.Y. 251; *Brill* v. *Tuttle*, 81 N.Y. 454; *Schmittler* v. *Simon*, 101 N.Y. 554.) That rule as now tersely stated in our Negotiable Instruments Law may be paraphrased as follows: "An instrument to be negotiable . . . must contain an unconditional promise or order to pay a sum certain in money" (Subd. 2, sec. 20), "but an order or promise to pay out of a particular fund

is not unconditional." (Subd. 2, sec. 22.) The cases referred to, as well as the statute, make it entirely clear that the mere indication of a particular fund from which the maker of an instrument may reimburse himself, or a mere reference to a specified account which is to be debited with the amount called for by the instrument, does not affect its unconditionality, and it is only where the order or promise is to pay out of a particular fund that it is considered conditional in such sense as to destroy the negotiability of the instrument.

The bonds of this issue are payable solely out of the assets assigned and transferred to the trustee or out of the other assets of the express company. If the express company were a corporation this would clearly be an unconditional promise for it would be a general pledge of the credit of the maker; a tender of all it had to give in satisfaction of the debt. But the company is concededly not a corporation, although our statutes have invested it with certain corporate attributes. It is unnecessary to enumerate these since it cannot be disputed that in respect of the individual liability of the shareholders of a joint-stock company for the company debts, the common-law rule still obtains. Each shareholder is liable precisely as though he were a member of an unlimited partnership. (*Townsend* v. *Goewey*, 19 Wend. 424; *Dennis* v. *Kennedy*, 19 Barb. 517; *Wells* v. *Gates*, 18 id. 554; *Cross* v. *Jackson*, 5 Hill, 478.) Although, as we have stated, joint-stock companies have been granted certain privileges and immunities peculiar to corporations, this most distinctive difference between these corporate and non-corporate creatures of the law has been consistently preserved by the legislature and recognized by the courts. (Code Civ. Pro. secs. 1919–1924; *People ex rel. Winchester* v. *Coleman*, 133 N.Y. 279; *Van Aernam* v. *Bleistein*, 102 N.Y. 360; *Matter of Jones*, 172 N.Y. 575.)

From what has been said it must follow that if the clause in the bonds exempting the individual shareholders of the express company from liability is valid, the bonds are non-negotiable, because they are in effect, if not in explicit terms, made payable out of a particular fund, so that the promise to pay is not unconditional. The clause under discussion is the only substantial thing that differentiates these bonds from the ordinary corporate bonds which are issued and held by the millions and are recognized and classed as negotiable instruments. The maker of the bonds is an association having a business name, which it used in making them, having shares of capital stock, indefinite succession, and a number of other characteristics which the lay public associates exclusively with corporations. These considerations lend great force to the suggestion that as a matter of public policy the exemption clause referred to should be treated as nugatory, so that the bonds may be invested with that element of negotiability which may fairly be regarded as one of the principal items of their value, and one of the most important inducements to

their current sale and purchase. I deem it unnecessary to go quite so far as that in the case at bar, since I am convinced that the exemption clause is so repugnant to the terms, tenor and purpose of the bonds that it not only may but must be taken out of the instruments in order to preserve their negotiability, and even their validity. It would be rather difficult to explain upon what theory the obligation of these bonds could be enforced in an action at law if the exemption clause is retained as part of the bonds. The maker cannot be sued in its business name, and the officers which represent it can only be sued upon obligations for which an action could be maintained against all the shareholders. (Code Civ. Pro. sec. 1919.) We are presented, in short, with the legal paradox that a written obligation, obviously intended to be negotiable, cannot be enforced in a court of law. This is an anomalous condition so utterly at variance with the manifest purpose of the association in issuing these bonds, and so palpably destructive of the legal rights of the holders thereof, that we could hardly give the exemption clause the effect which its language imports without destroying the validity of the bonds themselves.

Since both the negotiability and the validity of the bonds may be secured by the abrogation of the exemption clause, and since there is nothing in the other terms of the instruments to prevent this manifestly just disposition of the case, I conclude this branch of the discussion with the recommendation that the exemption clause be held void, and that the bonds and coupons be held negotiable.

Gray and Haight, JJ., concurred with Hiscock, J.; Edward T. Bartlett, J., and Cullen, C.J., agreed with Werner, J., that the exemption clause must be held void.

ANDREWS BROS. CO. *v.* YOUNGSTOWN COKE CO.

58 U.S. Appeals, 444. 1898.

This was an action by the Youngstown Coke Company, limited, claiming to be a corporation organized under the law of Pennsylvania, against the Andrews Brothers Company.

Lurton, Circuit Judge. The first and principal question is whether the circuit court had jurisdiction. [In the amended petition] it was averred that the plaintiff was a corporation under the laws of Pennsylvania, and a citizen of that State.

The act of June 2, 1874, as amended (Pepper & Lewis's Digest of the Laws of Pennsylvania [1894], p. 3402), under which the defendant in error was organized, is in seventeen sections. The first provides that three or more persons desiring to organize under the act may do so by preparing, signing, and acknowledging a statement in writing which shall set forth the amount of capital subscribed for by

each; the total amount of capital, and when and how to be paid; the character of the business, and location thereof; the name of the association, with the word "limited" added thereto as a part of it; the duration of the association, which shall not exceed twenty years, and the name of the officers selected in conformity with the act. The second section provides that the members of the association shall not be liable for the debts or engagements of the company beyond their unpaid subscriptions to the capital. The fourth section provides that interests in such association shall be personal estates, and may be transferred, given, bequeathed, distributed, sold, or assigned under such rules and regulations as shall be adopted from time to time "by a vote of a majority of the members in number and value of their interests; and in the absence of such rules and regulations the transferee of any interest in any such association shall not be entitled to any participation in the subsequent business of such association, unless elected to membership therein, by a vote of a majority of the members in number and value of their interests. And any change of ownership, whether by sale, death, bankruptcy, or otherwise, which occurs in the absence of any rules and regulations of such associations regulating such transfer, and which is not followed by election to membership in such associations, shall entitle the owner or transferee only to the value of the interest so acquired at the date of acquiring such interest, at a price and upon terms to be mutually agreed upon, and in default of such agreement, at a price and upon terms to be fixed by an appraiser to be appointed by the court of common pleas of the proper county, on the petition of either party, which appraisement shall be subject to the approval of said court." The fifth section provides for a board of managers, who shall be not less than three or more than five, one of whom shall be chairman, one the treasurer, and one the secretary. This section also provides that "no debt shall be contracted or liability incurred for such association, except by one or more of the managers, and no liability greater than five hundred dollars, except against the person incurring it, shall bind the association, unless reduced to writing and signed by at least two managers." The sixth and seventh sections provide for distribution of profits through dividends, such dividends not to impair capital, and that it shall be unlawful to lend its credit, name, or capital to any member, or to any other person, without consent of a majority in number and value of members in writing. The eighth, ninth, and tenth sections provide how such companies may be dissolved, and how the property shall be distributed. The remaining parts of the act provide, first, that the association may sue and be sued in its associate name, service of process to be made upon one of its officers, or on any agent, clerk, or manager in counties where it may maintain an office; and, second, that such association may acquire, hold, and convey real estate in its associated name.

This act does not declare these associations to be corporations, nor are they styled corporations. They are called "partnership associations." Neither does the act disclaim a purpose to create corporations, as was the case under the English and New York joint-stock acts (6 & 7 Wm. IV, local and personal acts, c. 119; 10 & 11 Vict., local and personal acts, c. 268; 27 & 28 Vict., local and personal acts, c. 116; Laws of New York of 1849, p. 389, c. 258, as amended by the Laws of 1853, p. 283, c. 153; Laws of 1854, p. 558, c. 245; Laws of 1867, p. 576, c. 289) mentioned and construed in *Liverpool Insurance Company* v. *Massachusetts*, 10 Wall. 566, and *The People ex rel. Winchester* v. *Coleman*, 133 N.Y. 279. But the fact of corporation or no corporation must depend upon the existence or nonexistence of those faculties which are of the essence of corporate existence. We need not be too attentive to mere names. The inquiry must go deeper and its solution be reached upon principle.

It is not essential to the idea of a corporation that it shall have perpetual existence, for limited corporations are a matter of most common occurrence, whether organized under special or general laws. Neither is it essential that it shall have capacity to sue and be sued under its corporate name, for it may be authorized only to sue in the name of one of its officers, as was the case under the New York banking law. Laws of 1838, p. 245, c. 260. That it shall have capacity to sue and be sued under some name standing for the collective body is all that is necessary. *Thomas* v. *Dakin*, 22 Wend. 9; *Liverpool Insurance Company* v. *Massachusetts*, 10 Wall. 566. In the last analysis the only absolutely essential attribute of a corporation is the capacity to exist and act within the powers granted, as a legal entity, apart from the individual or individuals who constitute its members.

But these associations authorized by the Pennsylvania act of 1874 possess every attribute deemed essential to the existence of a corporation under any authoritative definition of a corporation. They come into being only by the creative power of the sovereign will as expressed in the statute which authorizes their organization. That act constitutes at once the authority for their existence and the measure of their powers. When organized, they constitute a new artificial person, endowed with the power of suing and being sued, and of acquiring, holding, and conveying property, in its artificial character. Created by compliance with the constituting law, they can be dissolved only in the way pointed out by that law. Individual liability for corporate debts, beyond unpaid subscription to the capital stock, does not exist. *Oak Ridge Coal Company* v. *Rogers*, 108 Penn. St. 147, 150; *Stevens* v. *Phila. Ball-Club*, 142 Penn. St. 52, 61. The members do not act as individuals, or as partners, but through and in the name of the collective or corporate body. *Hill* v. *Stetler*, 127 Penn. St. 145, 161, 162. The members are not liable individually for the torts of the association, unless they personally participate.

Whitney v. *Backus*, 149 Penn. St. 29. In all these respects it would be difficult to distinguish these companies from the ordinary business corporations authorized under general acts in most, if not all, of the States of the Union. In other respects they are somewhat peculiar, and it is these peculiar features which distinguish them from the ordinary business corporations provided for by other Pennsylvania legislation, and which have led to some confusion in defining their character. Thus the managers alone may create a debt, and no liability in excess of $500 is valid unless the contract be in writing and signed by two, at least, of the managers. This is a mere limitation upon the usual powers of officers and agents to bind the artificial body, and in no way affects the corporate character of that body. But the most marked peculiarity is found in the provisions of the fourth section of the constituting act, whereby in the absence of some other regulation, adopted by the members, the assignee of the interest of a member in the capital stock, by operation of law or otherwise, does not become a member until elected. In default of election the association must pay the value of the interest as ascertained by agreement, or, in default thereof, by an appraiser, provided for in the statute. This *dilectus personarum* is a most inviting inducement to the formation of small business corporations where the personnel of the members is a matter of some importance, and is the only feature which particularly distinguishes these associations from ordinary corporations. This power of selection is similar to that belonging to ordinary copartnerships. A member may sell his interest, but such sale dissolves the partnership. If the remaining members assent to the admission of the new member the legal result is a new firm. Under this provision of the act of 1874 the sale of an interest does not operate as a dissolution, but requires that the company shall buy the interest unless the transferee is acceptable. The principle is not new in partnerships where the partners give a preference to the firm or its members by contract in event of sale or other devolution of title.

But does the existence of the *dilectus personarum* take from the body possessing it the character of a corporation if it possesses those attributes which by general consent distinguish a corporation from a mere voluntary association? The general and well-settled rule is that, in the absence of statutory authority, a corporation may not make the transfer of shares dependent upon the discretion of the corporation, its officers or agents. They may by reasonable rule regulate such transfer, but they cannot prohibit. Morawetz on Private Corporations (2d ed.), §§ 164, 165. But that this power may be conferred by the charter is equally well settled. Morawetz on Private Corporations (2d ed.), §§ 164, 165, and authorities cited; Lowell on Transfer of Stocks, § 31. This privilege of the *dilectus personarum*, while unusual in corporations for profit, is a very common provision in the

charters of companies not for profits, such as clubs, boards of trade, fraternal societies, and educational and charitable associations.

Joint-stock companies have no invariable character. Sometimes they are incorporated and sometimes they are not. The test is the attributes conferred by the statute under which they are organized.

GREAT SOUTHERN FIRE PROOF HOTEL CO. *v.* JONES.

177 U.S. 449. 1899.

MR. JUSTICE HARLAN. The bill in this suit, commenced in the Circuit Court of the United States for the Southern District of Ohio, Eastern Division, describes the plaintiffs Benjamin F. Jones, George M. Laughlins, Henry A. Laughlins, Jr., and Benjamin F. Jones, Jr., as "members of the limited partnership association doing business under the firm name and style of Jones & Laughlins, Limited, which said association is a limited partnership association, organized under an act of the General Assembly of Pennsylvania, approved June 23d [2d], 1874, entitled 'An act authorizing the formation of partnership associations in which the capital subscribed shall alone be responsible for the debts of the association, except under certain circumstances,'" and who "have their office and principal place of business in the city of Pittsburg," and which association is "a citizen of the State of Pennsylvania." Penn. Laws, 1874, p. 271.

The defendant first named in the bill is the Great Southern Fire Proof Hotel Company, a corporation of the State of Ohio; and some of the defendants are corporations and citizens of States other than the State of Pennsylvania.

The bill rests the jurisdiction of the circuit court upon the ground of the diverse citizenship of the parties.

We are of opinion that the plaintiff as a limited partnership association was not entitled to invoke the jurisdiction of the Circuit Court. It was not alleged to be, nor could it have alleged that it was, a corporation in virtue of the statute of Pennsylvania under which, according to the averments of the bill, it was organized. In *Lafayette Ins. Co.* v. *French*, 18 How. 404, 405, which was an action brought by citizens of Ohio in the Circuit Court of the United States for the District of Indiana, the declaration described the defendant as the "Lafayette Insurance Company, a citizen of the State of Indiana." This court said: "This averment is not sufficient to show jurisdiction. It does not appear from it that the Lafayette Insurance Company is a corporation; or if it be such, by the law of what State it was created. The averment that the company is a citizen of the State of Indiana can have no sensible meaning attached to it. This court does not hold that either a voluntary association of persons, or an association

into a body politic, created by law, is a citizen of a State within the meaning of the Constitution. And, therefore, if the defective averment in the declaration had not been otherwise supplied, the suit must have been dismissed." The case of *Chapman* v. *Barney*, 129 U.S. 677, 682, is decisive of the present question. That was an action in the Circuit Court of the United States by the United States Express Company. This court said: "On looking into the record we find no satisfactory showing as to the citizenship of the plaintiff. The allegation of the amended petition is, that the United States Express Company is a joint-stock company organized under a law of the State of New York, and is a citizen of that State. But the express company cannot be a *citizen* of New York, within the meaning of the statutes regulating jurisdiction, unless it be a corporation. The allegation that the company was *organized* under the laws of New York is not an allegation that it is a corporation. In fact, the allegation is, that the company is *not* a corporation, but a joint-stock company — that is, a mere partnership. And although it may be authorized by the laws of the State of New York to bring suit in the name of its president, that fact cannot give the company power, by that name, to sue in a Federal court. The company may have been organized under the laws of the State of New York, and may be doing business in that State, and yet all the members of it may not be citizens of that State. The record does not show the citizenship of Barney or of any of the members of the company. They are not shown to be citizens of some State other than Illinois. *Grace* v. *American Central Ins. Co.*, *supra*, and authorities there cited. For these reasons we are of opinion that the record does not show a case of which the Circuit Court could take jurisdiction."

It has been suggested that the plaintiffs are entitled to sue, and may be sued, by their association name. 1 Brightly's Purdon's Digest, Pa. (12th ed.) 1088, Title Joint Stock Companies, § 16. But the capacity to sue and be sued by the name of the association does not make the plaintiffs a corporation within the rule that a suit by or against a corporation in its corporate name in a court of the United States is conclusively presumed to be one by or against citizens of the State creating the corporation. *Louisville, Cincinnati & Charleston Railroad Co.* v. *Letson*, 2 How. 497; *Ohio & Miss. R.R. Co.* v. *Wheeler*, 1 Black, 286; *Steamship Co.* v. *Tugman*, 106 U.S. 118, 120. The rule that for purposes of jurisdiction and within the meaning of the clause of the Constitution extending the judicial powers of the United States to controversies between citizens of different States, a corporation was to be deemed a citizen of the State creating it, has been so long recognized and applied that it is not now to be questioned. No such rule however has been applied to partnership associations although such associations may have some of the characteristics of a corporation. When the question relates to the jurisdiction

of a Circuit Court of the United States as resting on the diverse citizenship of the parties we must look in the case of a suit by or against a partnership association to the citizenship of the several persons composing such association.

Nor can we accede to the suggestion that this question of jurisdiction is affected by the clause of the Constitution of Pennsylvania providing that the term "corporations," as used in article XVI of that instrument, "shall be construed to include all joint-stock companies or associations having any of the powers or privileges of corporations not possessed by individuals or partnerships." Const. Pa. art. XVI, § 13. The only effect of that clause is to place the joint-stock companies or associations referred to under the restrictions imposed by that article upon corporations; and not to invest them with all the attributes of corporations.

We have not been referred to any case in the Supreme Court of Pennsylvania which distinctly places limited partnership associations, created under the statutes of that State, on the basis of corporations. "Such an association," that court said in *Coal Co.* v. *Rogers*, 108 Penn. St. 147, 150, "is not technically a corporation, yet it has many of the characteristics of one," and "it may not be improper to call such an association a *quasi* corporation." In *Hill* v. *Stetler*, 127 Penn. St. 145, 161, referring to the act of June 2, 1874, the court said that it provided for the creation of "a new artificial person to be called a joint-stock association, having some of the characteristics of a partnership and some of a corporation."

In *Carter* v. *Producers' Oil Co., Ltd.*, 182 Penn. St. 551, 573, 574, which involved the validity of a rule adopted by a limited partnership association organized under the Pennsylvania statute of June 2, 1874, and its supplements, and which rule prohibited any person who acquired the capital stock of a member from exercising the privileges of a member, unless he was elected as such, the court said: "We cannot assent to the plaintiff's claim that the defendant company is a corporation and restricted, in the adoption of by-laws, rules and regulations for its government, to such as it is within the power of the latter to prescribe. It may be conceded that the defendant company has some of the qualities of a corporation, but it is, nevertheless, a partnership association, governed by the statutes and articles under which it was organized, and the rules and regulations it may prescribe in execution of the power with which the statutes have invested it."

That a limited partnership association created under the Pennsylvania statute may be described as a "*quasi* corporation," having some of the characteristics of a corporation, or as a "new artificial person," is not a sufficient reason for regarding it as a corporation within the jurisdictional rule heretofore adverted to. That rule must

not be extended. We are unwilling to extend it so as to embrace partnership associations.

We have not overlooked the case of *Andrews Bros. Co.* v. *Youngstown Coke Co.*, 58 U.S. App. 444, in which the Circuit Court of Appeals for the Sixth Circuit, speaking by Judge Lurton, held that limited partnership associations organized under the Pennsylvania statute were corporations within the jurisdictional requirement of diverse citizenship. For the reasons stated, we are unable to concur in the view taken by that court.

We therefore adjudge that as the bill does not make a case arising under the Constitution and laws of the United States, it was necessary to set out the citizenship of the individual members of the partnership association of Jones & Laughlins, limited, which brought this suit.

CHAPTER III.

UNDER WHAT, IF ANY, CIRCUMSTANCES THE CORPORATE FICTION SHOULD BE DISREGARDED.

RUSSELL *v.* TEMPLE.

3 Dane's Abridgment (Mass.) 108. 1798.

[PROBATE APPEAL.] In this case the heirs of Thomas Russell contended that his shares in Malden, Charles-River, Haverhill, Andover, and Merrimack bridges, in Middlesex Canal, etc., ought to be considered as real estate, and his widow, afterwards married to Temple, ought to have only her dower for life in them. On the other hand, Temple and wife contended they were personal estate, and ought to be distributed as such, and she have one-third part forever. The strongest case among these, in favor of real estate, was the Middlesex Canal, in which the corporation had a fee simple estate, or an estate forever, and a perpetual toll. By the statutes passed respecting this canal and real estate, the property therein was divided into 800 shares, and the shares in the canal, including the towing paths and wharves thereon, were made transferable and taxable as personal estate. This corporation also had power to hold real estate to the amount of £30,000, over and above the canal itself, and this appendant real estate was made taxable as real estate of the corporation in the several towns in which it lay.

It was argued (for the widow) that these shares were personal estate for two reasons: —

1st. Because these estates can only exist in the corporation, which alone can acquire it, alone be seized or possessed of it, alone pass it away, manage or repair it, and so must hold it entire; and that the corporation is a moral person to all the purposes of property. Its tenure is to their successors, or to their successors and assigns; these estates never can vest in or be divided among the individual members, to hold as tenants in common, etc., in their private capacities. Only the corporation can forfeit the estate, and that only by forfeiting their charter; and only the corporation can be taxed for it on common law principles; and on these can it alone be taken in execution for the debts of the corporation; and on a dissolution of the corporation, "its lands revert to the grantor, or his heirs, and the debts due to or from it are totally extinguished; so that the members of it cannot recover or be charged with them in their natural capacities."

And a grant to a corporation can only be for its life or continuance. 2 Bl. Com. 484; 1 Lev. 239; 1 Bac. Abr. 510. The case of the *Royal Exchange Insurance Company* v. *Vaughan*, 1 Burr. 155, and Cowper, 79 to 86, *Gardner's Case.*

2d. Because the share is personal estate, though the corporation hold real estate; for the individual member has no estate, but only a right to such dividends as the corporation, from time to time, assign to him. He is unknown on the grants made to it, and he cannot grant any part of the estate; nor can he be taxed for it but by statute law; nor can any private member of a corporation be distrained for a public concern of it; his only remedy for his dividend is case in *assumpsit*, or an action on the case for a wrongful refusal or neglect to pay or allow him his part of the profits. 4 Wood's Con. 489, etc.; Cowp. 85; Impey's Modern Pleader, 83; 1 Vent. 351; *Dutch* v. *Warren*, 1 Stra. 406; same case, 2 Burr. 1011. So lands may be real estate in one, yet the trees or corn growing on them may be personal estate in another. *Lifford's Case*, 6 Co. 46 to 50; Imp. M. P. 167.

For the heirs it was urged that these shares were real estate, because it was said the estates were real in the corporations; annexed to the soil; and that if these estates in the corporations were real, the estates of the individual members in them followed their nature, and were real; and that the frequent declarations of the legislature declaring such shares personal estate, at least shew a doubt: that when one has a right to receive rent, he has only a right to receive a sum of money; yet it does not follow that his estate is not real estate, out of which his rent issues.

The judgment of the court was, that these shares were personal estate, and distribution was ordered accordingly. The principal reason of the decision appears to be, because the court considered that the individual member, or shareholder, had only a right of action for a sum of money, his part of the net profits, or dividends. And so the law has been held to be since this decision was made.

NOTE. — While, in a broad sense, the corporation holds its property for the benefit of its shareholders, the relation between the corporation and its shareholders is a legal, not an equitable, relation.

The property of the corporation cannot be attached to recover a debt against a shareholder. *Williamson* v. *Smoot*, 7 Martin (La.) 31.

Service upon the X corporation does not bring the Y corporation before the court, even though the Y corporation owns practically all the stock of the X corporation. *Peterson* v. *Chicago Ry. Co.*, 205 U.S. 364.

PARKER *v.* BETHEL HOTEL CO.

96 Tenn. 255. 1896.

APPEAL from Chancery Court of Maury County.

On May 24, 1880, P. C. Bethel, W. D. Bethel, Lucius Frierson, Eugene Pillow, J. M. Mayes, and L. W. Black became incorporated, under the laws of the State of Tennessee, as the Bethel Hotel Company. The business of this corporation, as declared in its charter, was the erection, furnishing, and operation of a hotel in the town of Columbia, Tenn., the hotel building to include storehouses and a concert hall. The charter was taken out under chapter 142 of the acts of 1875, and was in the form prescribed for hotel companies, except that words were added authorizing it to build and own storehouses and a concert hall. The corporation was duly and regularly organized, with a capital stock of $100,000, divided into shares of $50 each. After its organization, the building contemplated by the charter was erected on a lot owned by the corporation. The building was used partly for a hotel, and partly for other purposes. September 1, 1885, the Bethel Hotel Company and Lucius Frierson conveyed to Mayes & Dodson the "hotel proper part" of the building, by deed signed "Bethel Hotel Company, W. D. Bethel, President; Lucius Frierson, Secretary and Treasurer; and Lucius Frierson." This conveyance was authorized by a vote of the stockholders at the last meeting ever held by them. No business seems to have been transacted by the corporation after this time. On or about August 28, 1886, Frierson became the owner of all the stock of the company; but, both before and after that date, he pledged various shares as security for debts of his which are still outstanding. The stock so pledged was not transferred on the books of the company. He used the remainder of the building as his own up to January 12, 1892, when he executed a deed in his own name, purporting to convey to Webster, in trust, the real estate owned by the Bethel Hotel Company and certain stock in that company. The purpose of this deed was to secure the payment of certain debts owing by Frierson, preferring one creditor and providing for *pro rata* payment of the others. Most of the creditors of Frierson who had loaned him money on the stock of the Bethel Hotel Company were not provided for in the deed of trust. Parker *et al.*, creditors of Frierson and pledgees of said stock, filed a bill in equity, praying (*inter alia*) to annul the trust deed to Webster. The cause was heard before the Chancellor of Maury County, and afterwards before the Court of Chancery Appeals, from which the case was taken to the Supreme Court.

J. C. BRADFORD, Sp. J. It may be regarded as settled, therefore, that the legal title to the property conveyed to defendant, Webster, was, at the date of that instrument, in the Bethel Hotel Company,

where it had been, unquestioned and undisturbed, since 1880, the year of its incorporation and organization. Defendants insist that, although Frierson may not have been invested with the legal title, he, nevertheless, had such an equitable estate and interest as entitled him to sell and dispose of the property. In other words, that he was the real owner of the property, and, as such, had the absolute right to use or dispose of it.

This alleged equitable estate was not the creation of any deed or written contract, executed by the Bethel Hotel Company, or of any corporate act or resolution adopted by the stockholders or directors, which in terms referred to or defined it, but is rather the result and consequence of certain facts and conditions, the existence of which is affirmed by the defendants.

It is said that the Bethel Hotel Company, by the alienation of that part of its property built for and adapted to the uses and purposes of a hotel, deprived itself of the means of conducting a hotel business, and that, since 1885, the date of the sale to Mayes & Dodson, it had ceased to exercise its corporate franchises; that the stockholders, at the meeting held in September, 1885, passed a resolution, or agreed among themselves, that the corporation should go into liquidation, and that Lucius Frierson, being then the owner of all the capital stock of the corporation, became, in consequence, the equitable owner of all its property, with full power to use it or dispose of it in such manner as he might choose to do. The position of the defendants seems to be that all rights of the corporation in the property were extinguished, that it had ceased to be affected with any corporate uses, and that it belonged absolutely to Frierson.

The facts affirmed by defendants are not all of them exactly as found by the Court of Chancery Appeals. It is true that the corporation sold and conveyed the hotel part of its building to Mayes & Dodson, retaining only the stores and opera house, and never afterwards engaged in the business of owning and operating a hotel. Lucius Frierson was not the sole stockholder in 1885, when the hotel was sold, and did not become such until August 28, 1886, when he purchased the Bethel stock. His stock, or a large part of it, at that time and subsequently, was held as collateral security by other parties. It is not true that a resolution was ever adopted by the stockholders directing the liquidation or winding up of the affairs of the corporation, or that they were ever wound up. The facts, as found by the Court of Chancery Appeals on this point, are stated in its opinion in the following words: "It may be fairly inferred, though it does not distinctly appear in terms in the proof, that when the deed was made to Mayes & Dodson it was then understood between W. D. Bethel and Lucius Frierson, they then owning practically all, or nearly all, of the stock, that Bethel should take the proceeds of the sale to Mayes & Dodson, amounting to $22,500, and a sufficient

amount, in addition, from Lucius Frierson, personally, to make $30,000, and for this he would transfer his stock, $61,000, to Frierson, and that this arrangement was consummated, so far as it could be done without direct corporate action of the corporation itself, by the paper of August 28, 1886, made by Bethel to Frierson, and this is what they understood by the resolution to go into liquidation, there being no debts due by the corporation, and, following out this idea, from the date of the sale to Mayes & Dodson, Lucius Frierson proceeded to treat the property as his own, on the idea that he himself constituted the corporation. We do not think that he entertained the idea that the corporation was defunct, but simply that he was, himself, the corporation, and could do what he wished with the assets."

In considering the position of the defendants, that Frierson became the equitable owner of the assets of the corporation, we must, therefore, leave out of view the idea that there was any corporate action looking to a dissolution of the corporation and winding up of its affairs. Frierson's estate or interest in the property, if he had any, rests on the postulate that, in consequence of the nonuser of its franchises and his sole proprietorship of all its capital stock, the corporation was dissolved, and he became the equitable owner of all its property.

A corporation can be dissolved, and its existence wholly terminated, only by the extinguishment of the corporate franchises conferred by the State. An ordinary business corporation, where its charter specifies no definite time for its continuance, may sell its property and wind up its affairs whenever a majority of the stockholders may deem it advisable (*Treadwell* v. *Salisbury Mfg. Co.*, 7 Gray, 393; *Black* v. *Delaware & C. Canal Co.*, 22 N.J. Eq. 416); but the franchises conferred upon the stockholders by the State are not extinguished by the cessation from business thus brought about. 2 Morawetz on Corp., § 1004.

It is claimed by the defendants that the dissolution of the corporation was effected by the fact that Lucius Frierson became the sole owner of all its capital stock. Admitting it to be true that he was the owner of all the stock of the corporation, it by no means follows that the corporation was thereby dissolved and forfeited its franchises. On this question the latest text writer on corporation law has this to say, viz.: "Contrary to early opinion, it is now generally held that the fact that all the shares in a joint-stock company have passed into the hands of two members, or even into the hands of a single person, does not, *ipso facto*, work a dissolution of the corporation, since such sole owner may so dispose of the shares, as, by the election of the necessary directors and officers, to continue the corporate existence." 5 Thompson's Commentaries on the Law of Corporations, § 6653. And, in 2 Morawetz on Corporations, § 1009, it is said: "It is well settled that all the shares of a corporation may be held

by a single person, and yet the corporation continue to exist, and, if the charter or by-laws should require certain acts to be done by more than one shareholder, the sole owner may transfer a portion of his shares to other persons, so as to conform to the letter of the rule." It has been held that a corporation which has sold all its assets, with the intention of putting an end to its business, whose officers had all resigned, and whose stockholders had all transferred their shares to a single person, was, nevertheless, not dissolved, and that its existence could be terminated only by judgment of forfeiture or by surrender accepted by the State. *Russell* v. *McLellan*, 14 Pick. (Mass.) 69, 70; *Newton Mfg. Co.* v. *White*, 42 Ga. 148; *Baldwin* v. *Canfield*, 26 Minn. 43.

The dissolution of a pecuniary or business corporation is effected in one of the following ways, viz.: (1) by the expiration of its charter; (2) by Act of the Legislature, where power is reserved for that purpose, or there is no constitutional inhibition; (3) by surrender of charter which is accepted; (4) by forfeiture of the franchises and judgment of dissolution pronounced by a Court having jurisdiction. 2 Morawetz, § 1004; Taylor on Private Corporations, § 430. It is not pretended that the Bethel Hotel Company was dissolved in either of the ways indicated. The charter of the corporation has not expired, neither has it been repealed by the Legislature, or been surrendered to the State by its members or stockholders. It may be true that there was a nonuser of its franchises by the corporation for a period of seven years or more, occasioned by the sale of the only property it owned which could have been used for hotel purposes. Undoubtedly the nonuser of its franchises by a corporation is ground for dissolution and forfeiture of its charter, at the instance of the State; but until sentence of dissolution has been pronounced by a court of competent jurisdiction, in a proper proceeding instituted for the purpose, the corporation will continue to exist, notwithstanding its failure to use its franchises. And forfeiture can only be decreed in a proceeding directly instituted for the purpose, by the State granting it. Code (M. & V.) § 1712; *State* v. *Butler*, 15 Lea, 104, 110; *Jersey City Gaslight Co.* v. *Consumers' Gas Co.*, 40 N.J. Eq. 427; *Broadwell* v. *Merritt*, 87 Mo. 95. Until dissolution has been thus judicially pronounced, neither the existence of the corporation nor its title to its property can be questioned collaterally.

We are bound to conclude, therefore, that the Bethel Hotel Company was not dissolved, or its franchises extinguished for any of the reasons alleged by the defendants, and that it is now a corporation endued with life, with authority to own property and exercise all the powers conferred on it by its charter.

Defendants insist that the alleged equitable estate of Lucius Frierson in the property of the Bethel Hotel Company did not depend alone upon the dissolution of the corporation, but resulted also from

the fact that he was the sole owner of all its capital stock. The proposition is, that if one person owns all the shares of stock of a corporation which owes no debts, he, in virtue of such ownership, becomes the equitable owner of all its property, or, at least, may sell and dispose of it by deed, if he choose to do so. This proposition is argued by counsel for defendant with force and ability, and is supported by some authority. It has found favor with the Supreme Court of Maryland (*Swift* v. *Smith*, 65 Md. 428, 433); but the decision of that learned court is opposed by the current of authority, and seems to us to overlook and ignore certain principles that are fundamental.

A corporation and its shareholders are distinct legal entities. In *Keith* v. *Clark*, 4 Lea, 718, this court held that, notwithstanding the State owned all the stock in the Bank of Tennessee, "the bank and the State are entirely different legal entities," and, in *Lillard* v. *Porter*, 2 Head, 175, it was said, "stockholders are totally distinct from the corporation." Important consequences result from this rule. The shareholders are neither responsible for the debts nor for the torts of the corporation. In the absence of special circumstances, the shareholders cannot be parties, either plaintiffs or defendants, in actions respecting corporate rights, nor have they any title or direct interest in the property of the corporation.

"Shareholders," says Thompson, "are not joint tenants or in any other sense co-owners of the corporate property, either before or after its dissolution. The title to it rests exclusively in the legal entity called the corporation. A share of the capital stock merely gives the right to partake, according to the amount put into the fund, of the surplus profits of the corporation, and ultimately, on the dissolution of it, of so much of the fund thus created as remains unimpaired and is not liable for debts of the corporation." Commentaries on the Law of Corporations, § 1071. As the shareholders have no direct interest in the corporate property, they cannot convey the real estate of the corporation, though all join in the deed.

In *Wheelock* v. *Moulton*, 15 Vt. 519, REDFIELD, J., stated the reasons for the rule in his usual clear and accurate style. In that case, Moulton and Hutchinson, sole proprietors and owners of all the stock of a corporation, conveyed its real estate, in mortgage, to secure the repayment of money borrowed of the plaintiff, Wheelock. He brought suit to enforce his mortgage. Judge REDFIELD said: "The fact that the signers of this deed owned the whole of the shares will make no difference in regard to the necessity of a vote of the corporation, in order to convey the land. The title to the land was in the corporation, not in the individual shareholders. The deed of one, or of any number of the stockholders, will not affect the title to the land. The share owners are not tenants in common of the land. They have no title whatever to any of the property of the corporation. It

is true that one who owned all the shares might control the corporation, and so he could if he owned a majority of the shares; but he could, in either case, do it only by a vote of the corporation, at a meeting held in strict accordance with the statutes of the corporation."

And in *Humphreys* v. *McKissick*, 140 U.S. 304, Mr. Justice FIELD, discussing the same question, said: "The property of a corporation is not subject to the control of individual members, whether acting separately or jointly. They can neither incumber nor transfer that property, nor authorize others to do so. The corporation — the artificial being created — holds the property, and alone can mortgage or transfer it, and the corporation acts only through its officers, subject to the conditions prescribed by law."

A very instructive case on this question is *Baldwin* v. *Canfield*, 26 Minn. 43. The facts of that case were very similar to those of this case, and the direct question now under consideration was passed upon. The opinion of the court was in accord with the cases above cited. See also *Button* v. *Hoffman*, 61 Wis. 20.

We are thus led, both by reason and authority, to the conclusion that Lucius Frierson, as sole stockholder of the Bethel Hotel Company, had no title, legal or equitable, to its property. The title to the property was in the Bethel Hotel Company, and could only be conveyed by it. The conveyance of its real estate is one of the most solemn acts of a corporation, and it can only be done in pursuance of a vote of the corporation, and by deed executed in the form and mode prescribed by law. Thompson's Commentaries on the Law of Corporations, § 5096. At common law a corporation could not execute a deed to realty except under seal; and the general corporations Act of 1875, under which the Bethel Hotel Company was organized, provides that, if the corporation have no seal, it shall be bound by the signature of its name by a duly authorized officer.

To have made a valid conveyance of the real estate of the company, it was necessary, therefore, that the deed should have been executed in the name of the corporation, under seal, if it had one, and, if not, its name should have been signed by an agent duly authorized by its governing agency, its board of directors. *Garrett* v. *Belmont Land Co.*, 94 Tenn. 460. As we have seen, nothing of this kind was done. The deed to defendant, Webster, was executed by Lucius Frierson, in his own name and under his own signature. The Bethel Hotel Company, although it owned the property, was in no sense a party to it. For this and other reasons given, the deed of Lucius Frierson, conveying the real estate of the Bethel Hotel Company to defendant, W. J. Webster, was void, and conveyed to him no title or interest therein.

NOTE. — The owner of all the stock of a corporation is not entitled

to replevy the property of the corporation from a stranger. *Button* v. *Hoffman*, 61 Wis. 20. Nor sue on a cause of action belonging to the corporation. *Fitzgerald* v. *Missouri Pacific Ry. Co.*, 45 Fed. 812.

Nor is he liable for the debts of the corporation. *Whiting* v. *Malden & Melrose Railroad*, 202 Mass. 298, 304; *Atchison R.R. Co.* v. *Cochran*, 43 Kan. 225. See also *Stone* v. *Cleveland Ry. Co.*, 202 N.Y. 352.

A court of equity, on winding up the affairs of a corporation on the expiration of its charter, cannot order a sale of the property of another corporation, although all the stock of the latter belongs to the former corporation. *Stewart* v. *Pierce*, 116 Iowa, 733. An English company, owning 98% of the stock of an American corporation, is not assessable to income tax upon the full amount of the profits of the American corporation. *Kodak, Limited* v. *Clark*, [1902] 2 K.B. 450.

COOK *v.* BURLINGTON.

59 Iowa, 251. 1882.

THE plaintiffs are the executors of the estate of James W. Grimes, deceased. They are residents of the city of Burlington, where the estate is situated. Part of the estate consists of shares of stock in the Dunleith and Dubuque Bridge Co., which is a corporation of that name, incorporated under the general incorporation laws of the State of Iowa, and having its principal place of business in Dubuque county. The corporation owns a bridge across the Mississippi River, from the city of Dubuque, Iowa, to the eastern shore of the river in the State of Illinois, and said bridge is all the tangible property owned by the corporation. The bridge was assessed for taxation at Dubuque, and the taxes were paid. The shares of stock in the bridge company held and owned by the estate of Grimes were also assessed for taxation for the same year at the city of Burlington. The plaintiffs claimed that the stock was not liable to taxation, and appealed from the board of equalization of the city of Burlington to the Circuit Court. Upon a trial in the Circuit Court it was held that the assessment of the stock was authorized by law, and plaintiffs appeal.

ROTHROCK, J. The assessment of the bridge as the property of the corporation was authorized by law. *Appeal of The Des Moines Water Company*, 48 Iowa, 324. Whether the shares of stock can be legally assessed and taxed as the property of the stockholders for the same year for which the property of the corporation is assessed and taxed was not determined in that case. It was said, however, that "the statute provides that the stock of such corporations shall be assessed at its cash value. When assessed and taxed under the statute,

stock must be taxed as the property of the respective owners, and there is no provision making the corporation liable therefor."

We have then the question in this case whether the shares of stock may be taxed in addition to the taxation of the property of the corporation.

And we may say, once for all, at the outset, that our views, as expressed in the case just cited, that the statute provides that the stock shall be assessed and taxed, remains unchanged. This conclusion is not founded upon any doubtful construction of the statute, but upon its plain, certain and unequivocal language and meaning. The statute imposing this burden upon the stock is found in section 813 of the Code, and is as follows: "Depreciated bank notes and the stock of corporations and companies shall be assessed at their cash value. . . ."

It is idle to contend in the face of this plain and explicit language that the legislature has not required that stock in corporations shall be assessed, and the only question now for determination is, does the legislature have the power to determine that the property of a corporation and the stock shall both be taxed.

Counsel for appellants contend that no such power exists, because it is duplicate or double taxation of the same property, and it is insisted that "this court has over and over again declared that double taxation is forbidden by our Constitution." If this statement were correct, and we should concede that the question here presented were one of duplicate taxation, the case could easily and speedily be disposed of by a prompt reversal. But, while it is true that this court in *Tallman* v. *Butler County*, 12 Iowa, 534, said that it "is neither the policy nor the justice of the law to tolerate double taxation," and in *U.S. Express Co.* v. *Ellyson*, 28 Id. 378, that "double taxation would be so unjust as to excite disfavor of both courts and legislature," and in *McGregor's Executors* v. *Vanpel*, 24 Id. 436, that mortgages upon real estate should be held to be taxable "unless this will lead to double taxation," yet it never has been held in this State, that what is denominated duplicate taxation is in excess of the legislative power. The most that can be said of these utterances of this court is, that it should be held in disfavor by courts and legislatures.

In Cooley on Taxation, 165, it is said: "It has properly and justly been held that a construction of the laws was not to be adopted that would subject the same property to be twice charged for the same tax, unless it was required by the express words of the statute or by necessary implication."

Upon the question as to whether the imposition of taxes upon the property of a corporation and upon the shares of stock in the hands of stockholders, the general observations upon the subject of duplicate taxation found in Cooley on Taxation, page 159, seem to us to be appropriate to be here quoted. It is there said: "A system of indirect

taxes, combined with a system of general taxation by value, must often have the effect to duplicate the burden upon some species of property or upon some persons, and the taxation of stockholders of a corporation and also of the corporation itself, must sometimes produce a like result. There is also, sometimes, what seems to be double taxation of the same property to two individuals, as where the purchaser of property on credit is taxed on its full value while the seller is taxed to the same amount on the debt. . . . Now, whether there is injustice in the taxation, in every instance in which it can be shown that one individual, who has been directly taxed his due proportion, is also compelled indirectly to contribute, is a question we have no occasion to discuss. It is sufficient for our purposes to show that the decisions are nearly, if not quite, unanimous in holding that taxation is not invalid because of any such unequal results."

It must be conceded that the taxation of the property of the corporation and also of the stock bears no resemblance to taxing the same tract of land twice to the same person, nor once to A, and again to B. That would be a double taxation, which we suppose would not be allowable in any State in the Union. It would be a direct discrimination and inequality in the exercise of the taxing power, which would impose a greater burden upon one citizen than upon another upon the same kind of property. But the case at bar is quite different. The corporation is a person distinct from the stockholder. It is true, it is what is denominated an artificial person, and may be said to be ideal and intangible. But that it is a person in law is the first principle learned by the student in opening any book on corporations. Its stockholders are distinct and different persons. They are usually not liable for its debts, and have no right to the enjoyment or possession of its property during the period of its duration or until it be dissolved by some procedure known to the law. The stockholder is entitled to dividends upon his stock, if there be any dividends, and the value of his stock depends upon prospective dividends, and the dividends depend upon the net earnings of the corporation. If the bridge in this case be taxed, the tax must be paid from the income, and this reduces the value of the stock, so that there is no duplicate taxation, so far at least as the tax upon the bridge reduces the value of the stock.

In *McGregor's Exec'rs* v. *Vanpel*, *supra*, this court held that a mortgage given to secure the payment of the purchase-money of the premises mortgaged is not exempt from taxation. In that case it is said that "a system of assessments operating with entire equality and with absolute justice is a desideratum in government yet unattained, and perhaps unattainable." And in *Finley* v. *Philadelphia*, 32 Pa. St. 381, it is said: "There is nothing poetical about tax laws, whenever they find property they claim contribution for its protection without any special respect to the owner or his occupation."

The best devised system of taxation based upon the values of property must, of necessity, produce unequal results, so long as the attempt is made to tax all property including real estate, personal chattels, and moneys and credits. One person will be taxed upon the real estate bought upon credit, and another upon the obligation which he holds for the purchase-money. And this must necessarily be so or there would be but little taxation upon credits, because, for the most part, they are either the representative of money or property of some kind held by another. If as is said in Cooley on Taxation, p. 100, "all the property in a town is sold on credit and the property is taxed to the purchasers, and the debts to sellers, it is manifest that the town taxes twice as much wealth as lies within its borders." And yet under the system of taxation adopted by the State of Iowa, it cannot be claimed that the assessor must inquire of the owner of promissory notes, or mortgages, whether they are credits for taxable property which has been sold by the holder of these credits.

In the case at bar the stockholders paid to the corporation a certain sum of money. The corporation used this money in the construction of a toll-bridge from which the corporation derived an income. The agreement between the contracting parties is that the corporation is to manage and control the bridge, make the necessary repairs, and pay the taxes assessed against the bridge, and after deducting these legitimate and necessary expenses pay to the stockholder his proportionate share of the net earnings, and upon the dissolution of the corporation the stockholder is to be repaid his money advanced from the property belonging to the dead corporation. Now, suppose this very contract were made with a natural person instead of a corporation, and the stockholder or creditor should make a claim that the obligation held by him was not taxable. There would be no more grounds for such claim under our system of taxation than there would be for the claim that if A loans B $100, which is invested in merchandise, the debt is not taxable because the merchandise is taxable.

These illustrations, it appears to us, demonstrate that if we were to determine that the legislature has no constitutional power to impose this tax upon the stockholder, it would open a door into a sea of trouble in the administration of the revenue laws of the State.

In disposing of this important question we have not reviewed the authorities cited by the respective counsel of the parties. It is sufficient to say that these views are supported by the very great majority of adjudged cases upon this subject. We think the circuit court correctly determined that the shares of stock are taxable. And if the public interests of this State require that either the property of a corporation of this character, or the stock therein be exempt from taxation, that relief must come from the law-making power. It will be understood that the decision in this case will have no applica-

tion to capital stock in manufacturing companies. By chapter 57 of the laws of 1880 such stock is exempt from assessment and taxation.

Affirmed.

NOTE. — *People* v. *Williams*, 198 N.Y. 54. A, "for his personal convenience," conveyed real estate to a corporation, and nearly all of the stock was held by A. Taxes were paid on the real estate. Held, the corporation must also pay a tax on its capital stock.

Cf. *Benedict* v. *Dakin*, 243 Ill. 384, 388. A contract to find a purchaser for the assets of a corporation is satisfied by finding a purchaser for all the stock of the corporation.

JOHN FOSTER & SONS, LIMITED *v.* COMMISSIONERS OF INLAND REVENUE.

[1894.] 1 Q.B. 516.

CASE stated by Commissioners of Inland Revenue.

The Stamp Act imposes an *ad valorem* duty "upon conveyance or transfer on sale of any property." The consideration, as appears from another clause of the Act, need not always be money, but may be stock or marketable securities. The Act provides that the term "conveyance on sale" includes every instrument "whereby any property upon the sale thereof is legally or equitably transferred to or vested in the purchaser or any other person on his behalf or by his direction."

Eight persons, who had for many years carried on business in partnership as John Foster & Son, being desirous that the firm should be reconstructed as a Limited Company (registered with limited liability under the Companies Acts), agreed to terminate their partnership, and to transfer all the firm property to a Limited Company, styled John Foster & Son Limited, to be formed of all the partners exclusively for the purpose of taking over the same subject to all the liabilities; the whole of the ordinary shares, preference shares, and debenture stock of the company to be allotted among the partners in proportion to their respective shares in the partnership estate. In accordance with this agreement, by deed of indenture between the eight persons who composed the partnership and the Limited Company, registered under the Companies Acts under the name of John Foster & Son Limited, all the partnership property was conveyed to the Limited Company.

The Commissioners assessed an *ad valorem* duty upon the deed, as coming under the head of a "conveyance or transfer on sale."

In the Queen's Bench Division, CAVE, J., held that the assessment was erroneous, and WRIGHT, J., took the opposite view. WRIGHT, J.,

withdrew his judgment, and the appeal from the Commissioners was allowed.

From this decision of the Divisional Court, the defendants appealed to the Court of Appeal.

Counsel for respondents contended that in order to constitute a sale there must be two different parties capable of making an agreement, and there must be two different things, the property sold and the price given for it. In the present case there has merely been a re-arrangement of ownership. The parties remained the same, and nothing was parted with, and nothing was given. It was like a conveyance of property to trustees upon trust to carry on the business, and divide the proceeds arising from it amongst the conveying persons.

LINDLEY, L.J. I confess that, with great deference to CAVE, J., I cannot see the difficulty in this case.

The material sections of the Act of 1870 must first be considered. [The Lord Justice then read §§ 70 and 71 of the Stamp Act, 1870, and continued]: The importance of § 71, to my mind, is this: it shews that there may be a conveyance on sale, although the consideration for it is not cash or money, but may include or consist of stock or marketable securities. The definition of "stock" and "marketable securities" will be found in § 2. Then § 78 imposes a stamp duty on conveyances not otherwise charged, and the schedule shews what the stamps are that are imposed upon conveyances that are charged. First we have "conveyance or transfer whether on sale or otherwise" of certain stocks and dividends. The present case does not come within that head. Then we have "conveyance or transfer on sale, of any property" . . . "where the amount or value of the consideration for the sale does not exceed £5." That fits in with §§ 70 and 71. Then we come to "Conveyance or transfer by way of security of any property or of any security"; and then we have "Conveyance or transfer of any kind not hereinbefore described." We must accordingly consider under which of these heads the particular deed in this case comes. It certainly does not come under the first, nor under "conveyance or transfer by way of security of any property," and the alternative is between "conveyance or transfer on sale" and "conveyance or transfer of any kind not hereinbefore described."

Now, the document in this case is an indenture made between eight gentlemen of the first eight parts, and "John Foster & Sons Limited (hereinafter called 'the company'), of the 9th part." Pausing there for a moment: although the persons of the first eight parts may be, and were members, and the only members, of John Foster & Co. Limited, John Foster & Co. Limited is not those eight individuals; John Foster & Co. Limited, is a corporation. We have accordingly two parties, one party consisting of several individuals, and the other party consisting of a corporation. Whether they are or are

not the members, or the only members of the corporation, is wholly immaterial. The corporation is a totally different person from them in any capacity you choose to assign to them except a corporate one. [The Lord Justice then stated the recitals in and the operative part of the conveyances, and continued]: —

Then the parties of the first eight parts put their seals to the instrument, and the company puts its seal to it. Now, what is that instrument? It is certainly a conveyance of property; that is obvious. In order to amount to a conveyance of property there must be a person conveying and a person taking, and you have them both here. The persons conveying are the persons named in the first eight parts, and the persons taking are the corporation named in the ninth part.

Now, what is the consideration? The consideration for the transfer of this property is, I agree, not money, but it is stocks and securities, which for this purpose are to be regarded as equivalent to money by reason of § 71 of the Act to which I have already alluded. Then what have we got? To sum it up shortly, it is a conveyance of property from one person to another, for money, or what is, according to the provisions of the statute, equivalent to money. What is that except a conveyance on sale? What else can you call it? It is certainly not a gift; it is not an exchange; it is not a partition; it is not a mortgage. I do not know what it is unless it is a conveyance on sale. I do not know what is necessary to constitute a sale, except a transfer of property from one person to another for money, or for the purposes of the Stamp Act, for stock or marketable securities.

But then it is argued that it is only a redistribution of property. I do not consider it a redistribution at all. It is an entire transfer of property from one set of people to another person altogether, and whether there are, as there may well be hereafter, additional persons taking shares in this company, is perfectly immaterial.

Again it is argued on behalf of the appellants that this instrument is in substance nothing more than a conveyance to a trustee to carry on the business in trust for the grantor. Just try that. Supposing there is a conveyance by half-a-dozen people, transferring their property to a trustee on trust to carry on the business for them, can you in any sense of the word, legal or business-like, or otherwise, call that trustee a buyer? There is no buying, there is no sale to him at all, nor is there any money, or stock, or securities, or anything else parted with by him. Then it was urged that these shares can derive no value unless the company gets this property transferred to them. That is possible enough. That is to say, in other words, that the shares in the company would be valueless unless the company had assets. Of course they would be, but that does not affect the question whether there is a sale or a conveyance or not. I think myself that CAVE, J., has attached too little importance to the fact that you have here a

distinct seller, and a distinct buyer, and that in point of law it is immaterial that in the present case the buyer is a corporation which consists of the eight persons who formed, and who are, the partners. The appeal must be allowed.

NOTE. — *Jordan Marsh Co.* v. *Beals*, 201 Mass. 163. A guaranty in writing "to pay all bills . . . which may hereafter be contracted at your house by W," addressed to Jordan Marsh and Company, a copartnership, does not bind the guarantor to pay a bill, contracted by W. with the Jordan Marsh Company, a corporation, which, after the guaranty was executed and delivered, was organized by and composed of the same persons who formerly made up the copartnership and which carried on business at the same place and in the same manner that the copartnership had.

Brighton Packing Co. v. *Butchers' Association*, 211 Mass. 398. A made a lease to the Batchelder & Snyder Company, a South Dakota corporation. Later the Batchelder & Synder Company, a Maine corporation, was formed, and the lease assigned to it by the South Dakota corporation. Thereafter a modification and extension of this lease was executed by A and the Maine corporation. A was ignorant of the formation of the Maine corporation, and supposed that he was contracting with the South Dakota corporation. The court held that the modification and extension was not binding upon A. SHELDON, J., said (p. 403): "The claim has been made also that it is only in a technical sense that these two companies could be called distinct entities. They had the same capital stock and practically the same stockholders, officers and agents; the Maine company had taken over all the assets and assumed all the liabilities of the other, and was carrying on the same business, at the same stand, in the same manner and under the same management. The master has found that for practical purposes the two companies were the same. Accordingly the plaintiff contends that an agreement with the one is the same as an agreement with the other, that the defendant's ignorance of their separate identity was immaterial, that the agreement may be treated as made with either company indifferently, was capable of enforcement by either or at least by the Maine company, and is valid in the hands and for the benefit of the plaintiff. But we cannot assent to this reasoning. These are two distinct corporations, created by the laws of two different States. The powers of each corporation are limited and controlled by the statutes of the State which created it, and it is scarcely conceivable that the statutes of the two States are the same or that the franchises and powers of the two corporations are identical. But if this were so, it would remain true that they are the creation of two different governments, the offspring of different parents, and not only distinct legal entities, but having separate and distinct existences. They could and did make contracts

with each other; they might bring suits against each other. They are in no respect the same person."

Cf. *New York & Brooklyn Ferry Co.* v. *New York*, 146 N.Y. 145.

GALLAGHER *v.* GERMANIA BREWING CO.

53 Minn. 214. 1893.

MITCHELL, J. The plaintiff, as assignee of one Westphal under a general assignment for the benefit of creditors, brought this action to recover for goods sold and delivered by his assignor to the defendant corporation. Jacob Barge and John Vander Horck intervened, and set up in their complaint that they owned, and for nearly two years had owned (each one half), all the capital stock of the defendant, no other person but themselves having any interest in the stock or property of the corporation; that each of them had a valid and unsatisfied judgment against Westphal upon a cause of action which accrued before the assignment to plaintiff; that Westphal was, and for over two years had been, utterly insolvent; and that his estate, of which plaintiff is the assignee, was so hopelessly insolvent that it was insufficient to pay even the expenses of administering the assignment. The relief sought was that their claims against Westphal might be allowed, in equal amounts, as equitable set-offs to the claim of the plaintiff against the defendant corporation. From an order overruling a demurrer to the complaint, the plaintiff appeals, his contention being — First, that Barge and Vander Horck had no such interest in the litigation as to entitle them to intervene; second, that their claims cannot be set off against a claim against the corporation, because a corporation is a legal entity, entirely distinct from its stockholders. These two propositions amount really to the same thing, for, if Barge and Vander Horck cannot set off their claims against that of plaintiff against the corporation, they have no such interest in the subject of litigation as would entitle them to intervene; on the other hand, if their claims are proper equitable set-offs, their right to intervene for the purpose of setting them up is very clear. The case is certainly a novel one, for we doubt whether an instance can be found in the books where stockholders ever attempted to set up their several equities by way of set-off to claims against the corporation. Of course, the want of a precedent is by no means controlling with courts, especially in administering equitable relief; but it would seem that, if the relief here asked was consistent with legal or equitable principles, some case would be found where it had been granted.

The facts of the present case appeal to a natural sense of justice, for while, by action of law, a corporation is a distinct entity, yet in

reality it is an association of persons who are in fact the beneficial owners of all the corporate property. Hence, if interveners cannot set off their claims, the practical result is that Westphal's estate will collect its entire claim out of what is really their property, while the estate is at the same time indebted to them on claims of greater amount, which they will wholly lose because of Westphal's insolvency; but, as has been often said, hard cases are liable to make bad law.

The right of equitable set-off is, of course, not derived from, or dependent upon, statute, but rests upon a distinctly equitable doctrine, which courts of equity have applied on certain well-recognized equitable grounds, the object being to effect a clear equity and prevent irremediable injustice; and it may be stated as a general rule that, whenever necessary to accomplish that end, the courts will permit an equitable set-off, although the debts accrued in different rights; as, for example, by allowing a separate debt to be set off against a joint debt, or, conversely, a joint debt against a separate debt. They will also disregard the nominal parties to the record, and consider the real parties in interest; as, for example, when the assignor of a chose in action sues for the benefit of the assignee, or a trustee for the benefit of the *cestui que trust*. Hence, had the plaintiff's claim been a joint one against the interveners, there would have been no doubt of their right to set off their separate claims against it, for insolvency is well recognized as a distinct equitable ground for allowing such a set-off. But such a case is not analogous to the present. To allow the set-off here, it is necessary to wholly ignore the legal doctrine, or fiction, whichever you may call it, that a corporation is an entity separate and distinct from the body of its stockholders, and to treat it as a mere association of individuals who are the real parties in interest. In dealing with the rights of creditors, and the obligations existing between a corporation and its shareholders by reason of their contract of membership, undoubtedly the courts often find it necessary to consider the real parties in interest as the individual shareholders; but it may be laid down as a rule that, except in such cases, it has been found absolutely essential, for the administration of justice, to treat a corporation as a collective entity, without regard to its individual shareholders. In no other way can the title to corporate property be kept free from complication and uncertainty. The transferable nature of stock in a corporation is also a good reason why the theory of a corporate entity should be preserved, and why it is necessary to discriminate sharply between corporate rights and obligations and those of shareholders personally. If the rights or liabilities of a corporation could be affected by the acts of the stockholders, except when acting in the corporate name, or if shareholders could set up their several equities against persons having claims against the corporation, or, conversely, if

claims in favor of the corporation could be set off against claims against individual stockholders, it can easily be seen into what confusion and chaos corporate affairs would inevitably fall.

Inasmuch as the two interveners own all the stock of this corporation, the facts of this case seem comparatively free from embarrassments, and the contention of respondent quite plausible. But, suppose there were fifty other stockholders (which would not alter the principle), what would be the result? Could interveners then interpose their claims as set-offs, and, if so, could they do so to the full amount of their claims, or only in the proportion which their shares bore to the whole capital stock? And, if the former, would they have a claim for the excess against the corporation, or a right to call on the other stockholders for contribution?

Again, the right of set-off, if any exists, must be mutual. Hence, if stockholders can interpose their individual demands as set-offs to a demand against the corporation, it follows that a defendant can set up demands against the individual stockholders as set-offs to demands in favor of the corporation.

Illustrations might be multiplied indefinitely to show that to recognize any such right would result in the worst sort of complications, and that the only safe or sound rule is to adhere strictly, in such cases, to the doctrine of a corporate entity distinct from the individual stockholders.

What means, if any, the interveners might have had, or may hereafter have, of protecting themselves, it is not now our business to inquire, but we are clear that their claims against plaintiff's assignor are not the subjects of equitable set-off to a claim against the defendant corporation.

Order reversed.

NOTE. — Cf. *Gay* v. *Hudson River Co.*, 187 Fed. 12, where the officers of a subsidiary corporation agreed that claims by it might be offset by claims against the parent corporation.

JACKSON *v.* HOOPER.

76 N.J. Eq. 592. 1909.

DILL, J. The bill and injunction in this case rest upon the theory that the complainant, who united with the defendant Horace E. Hooper in acquiring in equal shares all the stock of two foreign corporations, pursuant to an agreement claimed to create a partnership or joint adventure, is entitled to treat the two corporations, organized under foreign laws, as mere agencies or instrumentalities in the conduct of the joint business and to subject not only the stock

owned by both parties, but all the corporate property to the control of the court of chancery according to the principles of the law of partnership.

Prior to 1900 the complainant and the defendant Horace E. Hooper had been associated in London, England, in the business of publishing and selling subscription books, "through the agency of a company known as 'The Clarke Company, Ltd.,'" an English corporation. In 1900 they acquired in equal portions all the stock of that company under an agreement that "upon the acquisition of the Clarke interests and so long as they might be associated together in business, their general policy in respect of their joint undertakings should be determined by mutual assent, each to have and exercise the authority and control of equal partners."

In 1902, to avoid the English tax law, the business transacted in England was separated from that conducted elsewhere. The Clarke Company, Ltd., was dissolved, and its assets and all the business carried on by the parties in interest were conveyed to two corporations, one "Hooper & Jackson, Ltd.," of England, to carry on the business in the United Kingdom; the other, a New York corporation, "The Encyclopædia Britannica Company," to operate elsewhere. The stock and securities of these corporations were issued to the two parties equally in payment for the property thus acquired by the corporations from these parties. The bill alleges that both these corporations were "intended to become merely instrumentalities or agencies for carrying out certain partnership purposes," and to be subject to the original agreement.

In 1903, for reasons of their own, the parties dissolved the New York corporation and transferred its assets to an Illinois corporation of the same name and under the same general understanding that the business should be carried on as a partnership, with five directors, of whom the complainant and Hooper were two, the other three being "nominal" directors.

As to the "nominal" directors the bill alleges in the plainest language that they were mere dummies, both in the New York company and its successor, the Illinois corporation, and says: "It was clearly understood that the election of particular persons to these three positions was not intended to, and did not, confer upon them any authority or control or the management of the business of the plaintiff and Hooper, but that at all times such persons, employes or others, should have no right or authority whatever in corporate matters other than to vote as directed by Hooper and the plaintiff acting jointly."

From 1902 to 1908 the business in which the companies were engaged, including the publication of the Encyclopædia Britannica, extended all over the civilized world and ran up into millions, the accounts receivable alone, at the time of the filing of the bill, amount-

ing to over $2,000,000. During all this time, according to the bill, the business was conducted in the names of corporations but always in accordance with the original agreement as to equal ownership, interest, authority and control, the three nominal directors being mere employes and automatons of the parties, and the existence of the corporations being always disregarded "except as agencies and instrumentalities created by them for carrying out certain of their co-partnership purposes."

In 1908 the complainant and Hooper quarreled as to the business policy, and their differences having become irreconcilable the theretofore dummy directors voted with Hooper and against the complainant. This, as the bill puts it, constituted a breach of the so-called partnership agreement that Jackson and Hooper should have equal control and equal voice in the management of the companies and that the other three directors should be and remain dummies.

The charge of the bill is that Hooper and the three nominal directors passed corporate resolutions and amended by-laws which changed the complainant's alleged partnership control, contrary to his wish, or, in other words, that the three dummy directors, assisting Hooper, practically ousted the complainant from his alleged partnership control over the corporation. This was done by the passage of resolutions, as, for example, requiring checks to be signed by two officers, thus putting it out of the complainant's control to draw on the assets of the company, as a partner would, whenever he saw fit and by his own check.

The relief asked for is that the court appoint a receiver of all the assets and joint property of the complainant and the defendant Horace E. Hooper, including their stock in the two corporations, such receiver to have the usual powers of receivers of assets of a copartnership; that the defendants — directors of the Illinois corporation — be restrained from selling any of the assets of the copartnership, including such stock, or from voting upon the same; from withdrawing from the business heretofore conducted by Hooper and the complainant or from any one of their bank accounts, in whatever name the same may be, any money otherwise than in the ordinary course of business; that defendants be restrained from preventing complainant from participating, as prior to 1908, in the conduct of the business carried on by the complainant and Hooper, whether the said business is carried on in the name of themselves or their companies; that the defendants be enjoined from causing any assets of the copartnership to be transferred to or by the Illinois corporation, irrespective of the name in which such assets stand, from selling either the English or American rights of the Encyclopædia Britannica, eleventh edition, or disposing, except in the ordinary course of business, of any other assets of the copartnership, whether they stand in individual or corporate names; that the copartnership be dis-

solved, that an account be taken and that the assets of the copartnership be sold and distributed between the complainant and Horace E. Hooper.

After a careful review of the facts the vice-chancellor concluded that while the complainant had been unable to establish the existence of a copartnership between himself and Horace E. Hooper, he did prove that "the series of transactions set out in the bill . . . belonged to that class of transactions which are known by the name of joint adventures" and are subject to the same rules of law which apply to partnerships. He held that the complainant was entitled to a preliminary "injunction broad enough to hold the *status quo* and yet so limited as not to interfere with the orderly, regular and usual conduct of the business."

He granted an injunction which, although reciting that nothing therein should "interfere or be deemed to interfere with the integrity or autonomy of the two corporations mentioned in the bill of complaint, to wit, Hooper and Jackson, Ltd., an English corporation, and the Encyclopædia Britannica Company, an Illinois corporation, or either of them, or to interfere with the business or property of either of said corporations, *except as herein specifically stated*," forthwith proceeds to enjoin the defendants, who, with the complainant, constitute the entire boards of directors of the English and Illinois corporations, from transferring any of the shares of stock therein, from withdrawing from the business of the complainant and Hooper or "from any one of the bank accounts of the said business, in whatever name the same may be, any money or moneys for the private or personal use of the defendants . . . or otherwise than in the payment in the ordinary course of business," except that such defendants as are employes may receive their respective salaries. He further issued a mandatory injunction that the complainant and the defendant Horace E. Hooper may withdraw such sums for their private use as they may mutually agree upon, or, in absence of an agreement between them, that each may draw $5000 per month; that either complainant or said Hooper shall have the right to sign checks for such amount, except that any debt of the business may be paid out of the funds thereof in whatever name standing. The order further enjoins the defendants from interfering with the complainant in his entrance and exit to and from any office where the business is carried on or in his examination of its books and accounts, and proceeds to enjoin the defendants from transferring or causing to be transferred any of the assets of the English corporation to the Illinois corporation, or *vice versa*, except in the regular course of business, and from "selling or causing to be sold" the rights of the Encyclopædia Britannica Company in the eleventh edition, or "any assets of the said business carried on by the complainant and the defendant Horace E. Hooper, in whosesoever name the same may stand."

In our view of the case the fundamental question is not whether the complainant has established the agreement alleged, but whether, assuming that he has, the court has the power to enforce it.

The first question to be discussed is whether, assuming the fact of the partnership or joint adventure as alleged to be satisfactorily proven, the complainant and the defendant, after the organization of the foreign corporations, were, as matter of law, partners or merely shareholders.

It is conceded that the corporations in question were legally organized, existing and doing business under foreign laws. It is not disputed that when the corporations were formed and the stock and bond interests acquired the parties retained no legal title to the property or business transferred. It is not questioned that the forms of law were complied with by the election of directors and officers and the prosecution of the corporate business. Indeed, the record abounds with evidence establishing the fact that the corporations as such, through their officers and agents, made contracts and in general transacted the business for which they were organized. Thus, from 1904 to 1909, promissory notes for over a million dollars were executed by and in the name of the Illinois corporation.

It is true that directors' and stockholders' meetings were seldom held and that the financial and other business affairs of the corporation were often informally and loosely conducted; yet, on the whole, the operations of the companies were the same as those of innumerable other so-called "close corporations" in which all the stock is held by a few persons who are as one in the conduct and policy of corporate action.

It is claimed, however, that these owners of all the stock were really copartners, doing business in corporate form for their own convenience, and that a court of equity has the power to control the property and affairs of the companies even to the extent of eliminating the corporate functions and powers as mere incidents and wholly disregarding the substantive law governing the creation, supervision and dissolution of corporations. We cannot subscribe to any such doctrine.

An agreement or course of dealing by which corporations are organized for the purpose of using them merely as agencies or instrumentalities, or forms in the conduct of a copartnership or joint business, and by the consent of the parties in interest to be independent of statutory control, cannot be recognized, enforced or perpetuated by the court of chancery in this state.

It is fundamental that, no matter how the shares of stock are held, the corporation itself is an entity wholly separate and distinct from the individuals who compose and control it.

The complainant and the defendant, though owning the entire capital stock of the two corporations, are not, as expressed by

Chief Justice WAITE in the leading case of *Pullman Palace Car Co.* v. *Missouri Pacific Railway Co.*, 115 U.S. 587, "the corporation, in the sense of that term as applied to the management of the corporate business or the control of the corporate property."

The law never contemplated that persons engaged in business as partners may incorporate, with intent to obtain the advantages and immunities of a corporate form and then, Proteus-like, become at will a copartnership or a corporation, as the exigencies or purposes of their joint enterprise may from time to time require.

The policy of the law is to the contrary. If the parties have the rights of partners they have the duties and liabilities imposed by law and are responsible *in solido* to all creditors.

If they adopt the corporate form, with the corporate shield extended over them to protect them against personal liability, they cease to be partners and have only the rights, duties and obligations of stockholders. They cannot be partners *inter sese* and a corporation as to the rest of the world.

Furthermore, upon grounds of public policy, the doctrine contended for cannot be tolerated as it renders nugatory and void the authority of the legislature — a co-ordinate branch of the government — established by the constitution in respect to the creation, supervision and winding up of corporations.

These views are amply sustained by abundant authority.

"A corporation is a legal person just as much as an individual," said the court in *Sheffield, etc., Building Society*, 22 Q.B.D. 476. And in *Society* v. *Abbott*, 2 Beav. 567, Lord LANGDALE, master of rolls, held that, as in this case, great confusion arises by failure to distinguish the body corporate from the individuals who constitute, "not the corporation, but all the members of the corporation."

The doctrine repeatedly urged by the complainant and adopted by the vice-chancellor, viz., that "the English and Illinois corporations were, respectively, agencies by which they (Jackson and Hooper) accomplished their results," was expressly repudiated by the House of Lords in *Salomon* v. *Salomon, Limited*, 45 Week. Rep. 193; L.R. App. Cas. (1897) 22, where Lord HALSBURY met this argument, saying: "I will, for the sake of argument, assume the proposition that the court of appeal lays down, that the formation of the company was a mere scheme to enable Salomon to carry on business in the name of the company. . . . Either the limited company was a legal entity or it was not. If it was, the business belonged to it and not to Salomon. If it was not, there was no person and no thing to be an agent at all, and it is impossible to say at the same time that there is and there is not a company."

And Lord MACNAGHTEN thus concurred: "The company is at law a different person altogether from the subscribers to the memorandum, and, though it may be that after incorporation the business is

precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them."

Two years earlier Lord-Justice LINDLEY asserted the same rule in the case of *Newman & Co.*, [1895] 1 Ch. 674, 685: "It is true that this company was a small one, and is what is called a private company, but its corporate capacity cannot be ignored. Those who form such companies obtain great advantages, but accompanied by some disadvantages. . . . An incorporated company's assets are its property and not the property of the shareholders for the time being. . . . The court is bound to recognize the company as incorporated, and to give effect to all the consequences of such incorporation."

The same theory and the same argument urged upon this court by the complainant's counsel were presented to the court of last resort of Massachusetts more than seventy-five years ago, and in a case strikingly similar to and on all fours with the case at bar. That court characterized the argument as ingenious but declared the theory fallacious and the conclusions unsound. *Russell* v. *M'Lellan*, 14 Pick. 63.

The Massachusetts court said of the bill in that case: "This was a bill in equity, setting forth that the plaintiff and the defendant were owners of a manufactory in Framingham from 1823 to the time of filing the bill; that in 1826 they organized themselves, under an act of incorporation passed in 1813, by the name of the Framingham Manufacturing Company, and that the business, both before and after such organization, was carried on by them jointly as partners, and praying for an account and for general relief."

The plaintiff and the defendant purchased in equal portions the entire stock of a manufacturing company pursuant to a written agreement that they should thereby become partners in the business thus carried on.

"During the period from 1823 to 1826 the business of manufacturing was carried on in the factory under the direction of the parties, sundry goods were manufactured and sold, sundry parcels of stock were purchased, and moneys were advanced and received by the parties, respectively, and some accounts were rendered by one to the other purporting to set forth some of their dealings. No regular corporate meetings were held during that period, but such formal proceedings as were had appear from two books produced by the defendant as the records of the corporation."

The issue was as to whether the plaintiff and the defendant were partners or shareholders. The court, after discussing the difference in law between a shareholder and a partner, said: —

"It was argued that the proposal of the defendant to the plaintiff to become jointly interested in this concern, each taking eight shares, made them partners or joint tenants or tenants in common,

ipso facto, upon its adoption. But we cannot perceive that inference, for the corporation continued. The parties did not, by the new arrangement, acquire a legal title to the corporate property. They had, indeed, joint and equal control over it, but their acts and doings must appear through the proceedings of the corporation in the due forms of the law.

"It is said that the parties held for two years without doing any corporate act. If it were so, we cannot perceive that they would become partners instead of corporators.

"Upon the whole, we are of opinion that these parties are not partners, tenants in common or joint tenants, and that the bill must be dismissed."

The court cited *Pratt* v. *Bacon*, 10 Pick. 123, likewise a decision of the court of last resort and to the same effect. The *Pratt Case* has been cited with approval in *Von Arnim* v. *American Tube Works*, 188 Mass. 515, and the *Russell Case* in *Welch* v. *Bank*, 122 N.Y. 189.

In this state, *Einstein* v. *Rosenfeld*, 38 N.J.Eq. (11 Stew.) 309, announces the same rule. The facts were similar to those in the case at bar, excepting that the corporation was a domestic one.

Chancellor RUNYON said: "It is urged, however, that in this case the corporation was but a mere form which the partners gave to what was, in fact, only a copartnership, and that this court is therefore at liberty to treat and deal with it as a copartnership. The bill alleges that the corporation is a *quasi* partnership. It appears by the answer that a partnership was at first agreed upon between the parties, but it was afterwards agreed between them to form a corporation instead. It is entirely clear that the court, in dealing with the subject, must treat the company as a corporation, and it cannot, in order to acquire jurisdiction over it to dissolve it, disregard and ignore its form and character."

This decision was quoted with approval by this court in *Sternberg* v. *Wolff*, 56 N.J. Eq. (11 Dick.) 389, which appeared again in chancery, 56 N.J. Eq. (11 Dick.) 555. Two sets of stockholders were contending for control. Complainant owned one half of the stock and defendant the other half. Suit was filed to restrain the defendant from acting as treasurer and for a receiver.

In denying an order for an injunction and receiver, Vice-Chancellor PITNEY held that the remedies available as between partners and "joint adventurers" cannot be applied to stockholders of corporations.

[The court then considered two further questions: (1) whether the alleged agreement that the directors of the Illinois corporation, other than Jackson and Hooper, should be mere nominal directors without the right to exercise independent judgment and subject to their joint dictation and control, was enforceable; and (2) whether the

injunction did not improperly assume to regulate the management of the internal affairs of foreign corporations.]

We hold that the parties are not partners as to the corporate property, but merely stockholders in two foreign corporations, distinct legal entities; that the agreement whereby these dummy directors were bound to act in accordance with the will of the complainant and Hooper was illegal and therefore unenforceable in any court; that the whole subject-matter of the controversy relates to, and the injunction attempts to regulate, the management of the internal affairs of two foreign corporations; that the court of chancery has no jurisdiction to entertain the bill and that the injunction and all proceedings thereunder should be vacated and held for naught.

For the reasons already given the order appealed from is reversed, with costs.

NOTE. — Cf. *In re Rieger*, 157 Fed. 609, in which the bankruptcy court, after appointing receivers of the property of certain partners, extended the receivership over the property of a corporation, substantially all the stock of which was owned by the partners. See also *Cole* v. *Price*, 22 Wash. 18.

BANK OF UNITED STATES *v.* DEVEAUX.

5 Cranch (U.S.) 61. 1809.

ERROR to the Circuit Court for the District of Georgia.

The declaration, or *petition*, as it is there called, was as follows: —

District of Georgia.

To the honourable the judges of the sixth circuit court of the United States, in and for the district aforesaid.

The petition of The President, Directors and Company, of the Bank of the United States, which said bank was established under an act of Congress entitled "An act to incorporate the subscribers to the Bank of the United States," passed the 25th day of February, 1791, showeth,

That Peter Deveaux and Thomas Robertson, both of the city of Savannah, Esquires, have endamaged your petitioners in the sum of three thousand dollars, for this, to wit, that the said Thomas Robertson, then acting under authority from the said Peter Deveaux, on the 20th day of April, 1807, at Savannah, in the district aforesaid, and within the jurisdiction of this honourable court, with force and arms entered into the house and premises of your petitioners, at Savannah aforesaid, and then and there seized, took, and detained, two boxes (the goods and chattels of your petitioners) containing each one thousand dollars in silver, then and there found in the pos-

session of your petitioners, and being of the value of two thousand and four dollars, and carried the same away, and converted and disposed thereof to their own use, and other wrongs to your petitioners then and there did against the peace of the district, and to the great damage of your petitioners; therefore your petitioners say they are injured, and have sustained damage to the value of three thousand dollars, and therefore they bring suit. And your petitioners aver that they are citizens of the State of Pennsylvania, and the said Peter Deveaux and Thomas Robertson are citizens of the State of Georgia. Wherefore your petitioners pray process, etc.

And the said Peter and Thomas, by R. L. their attorney, come and defend the force and injury, when, etc., and pray judgment of the declaration aforesaid, because they say that the sixth circuit court of the United States ought not to have and entertain jurisdiction of the said declaration, and the matters therein contained, for that the said president, directors and company of the bank of the United States aver themselves to be a body politic and corporate, and that in that capacity these defendants say they cannot sue or be sued, plead or be impleaded in this honourable court, by any thing contained in the constitution or laws of the same United States, and this they are ready to verify; wherefore, for want of jurisdiction in this behalf, they pray judgment, and their costs, etc.

To this plea there was a demurrer and joinder, and judgment in favour of the defendants upon the demurrer.

Marshall, Ch. J., The jurisdiction of this court being limited, so far as respects the character of the parties in this particular case, "to controversies between citizens of different States," both parties must be citizens, to come within the description.

That invisible, intangible, and artificial being, that mere legal entity, a corporation aggregate, is certainly not a citizen; and, consequently, cannot sue or be sued in the courts of the United States, unless the rights of the members, in this respect, can be exercised in their corporate name. If the corporation be considered as a mere faculty, and not as a company of individuals, who, in transacting their joint concerns, may use a legal name, they must be excluded from the courts of the union.

The duties of this court, to exercise jurisdiction where it is conferred, and not to usurp it where it is not conferred, are of equal obligation. The constitution, therefore, and the law, are to be expounded, without a leaning the one way or the other, according to those general principles which usually govern in the construction of fundamental or other laws.

A constitution, from its nature, deals in generals, not in detail. Its framers cannot perceive minute distinctions which arise in the progress of the nation, and therefore confine it to the establishment of broad and general principles.

The judicial department was introduced into the American constitution under impressions, and with views, which are too apparent not to be perceived by all. However true the fact may be, that the tribunals of the States will administer justice as impartially as those of the nation, to parties of every description, it is not less true that the constitution itself either entertains apprehensions on this subject, or views with such indulgence the possible fears and apprehensions of suitors, that it has established national tribunals for the decision of controversies between aliens and a citizen, or between citizens of different States. Aliens, or citizens of different States, are not less susceptible of these apprehensions, nor can they be supposed to be less the objects of constitutional provision, because they are allowed to sue by a corporate name. That name, indeed, cannot be an alien or a citizen; but the persons whom it represents may be the one or the other; and the controversy is, in fact and in law, between those persons suing in their corporate character, by their corporate name, for a corporate right, and the individual against whom the suit may be instituted. Substantially and essentially, the parties in such a case, where the members of the corporation are aliens, or citizens of a different State from the opposite party, come within the spirit and terms of the jurisdiction conferred by the constitution on the national tribunals.

Such has been the universal understanding on the subject. Repeatedly has this court decided causes between a corporation and an individual without feeling a doubt respecting its jurisdiction. Those decisions are not cited as authority; for they were made without considering this particular point; but they have much weight, as they show that this point neither occurred to the bar or the bench; and that the common understanding of intelligent men is in favour of the right of incorporated aliens, or citizens of a different State from the defendant, to sue in the national courts. It is by a course of acute, metaphysical and abstruse reasoning, which has been most ably employed on this occasion, that this opinion is shaken.

As our ideas of a corporation, its privileges and its disabilities, are derived entirely from the English books, we resort to them for aid, in ascertaining its character. It is defined as a mere creature of the law, invisible, intangible, and incorporeal. Yet, when we examine the subject further, we find that corporations have been included within terms of description appropriated to real persons.

The statute of Henry VIII, concerning bridges and highways, enacts, that bridges and highways shall be made and repaired by the "*inhabitants* of the city, shire, or riding," and that the justices shall have power to tax every "*inhabitant* of such city," etc., and that the collectors may "distrain every such *inhabitant* as shall be taxed and refuse payment thereof, in his lands, goods and chattels."

Under this statute those have been construed inhabitants who hold

lands within the city where the bridge to be repaired lies, although they reside elsewhere.

Lord COKE says, "every corporation and body politic residing in any county, riding, city, or town corporate, or having lands or tenements in any shire, *quæ propriis manibus et sumptibus possident et habent*, are said to be inhabitants there, within the purview of this statute."

The tax is not imposed on the person, whether he be a member of the corporation or not, who may happen to reside on the lands; but is imposed on the corporation itself, and, consequently, this ideal existence is considered as an inhabitant, when the general spirit and purpose of the law requires it.

In the case of *The King* v. *Gardner*, reported by Cowper, a corporation was decided, by the court of king's bench, to come within the description of "occupiers or inhabitants." In that case the poor rates, to which the lands of the corporation were declared to be liable, were not assessed to the actual occupant, for there was none, but to the corporation. And the principle established by the case appears to be, that the poor rates, on vacant ground belonging to a corporation, may be assessed to the corporation, as being inhabitants or occupiers of that ground. In this case Lord MANSFIELD notices and overrules an inconsiderate *dictum* of Justice YATES, that a corporation could not be an inhabitant or occupier.

These opinions are not precisely in point; but they serve to show that, for the general purposes and objects of a law, this invisible, incorporeal creature of the law may be considered as having corporeal qualities.

It is true that as far as these cases go they serve to show that the corporation itself, in its incorporeal character, may be considered as an inhabitant or an occupier; and the argument from them would be more strong in favour of considering the corporation itself as endowed for this special purpose with the character of a citizen, than to consider the character of the individuals who compose it as a subject which the court can inspect, when they use the name of the corporation, for the purpose of asserting their corporate rights. Still the cases show that this technical definition of a corporation does not uniformly circumscribe its capacities, but that courts for legitimate purposes will contemplate it more substantially.

There is a case, however, reported in 12 Mod. which is thought precisely in point. The corporation of London brought a suit against Wood, by their corporate name, in the mayor's court. The suit was brought by the mayor and commonalty, and was tried before the mayor and aldermen. The judgment rendered in this cause was brought before the court of king's bench and reversed, because the court was deprived of its jurisdiction by the character of the individuals who were members of the corporation.

In that case the objection, that a corporation was an invisible, intangible thing, a mere incorporeal legal entity, in which the characters of the individuals who composed it were completely merged, was urged and was considered. The judges unanimously declared that they could look beyond the corporate name, and notice the character of the individual. In the opinions, which were delivered *seriatim*, several cases are put which serve to illustrate the principle, and fortify the decision.

The case of *The Mayor and Commonalty* v. *Wood* is the stronger, because it is on the point of jurisdiction. It appears to the court to be a full authority for the case now under consideration. It seems not possible to distinguish them from each other.

If, then, the Congress of the United States had, in terms, enacted that incorporated aliens might sue a citizen, or that the incorporated citizens of one State might sue a citizen of another State, in the federal courts, by its corporate name, this court would not have felt itself justified in declaring that such a law transcended the constitution.

The controversy is substantially between aliens, suing by a corporate name, and a citizen, or between citizens of one State, suing by a corporate name, and those of another State. When these are said to be substantially the parties to the controversy, the court does not mean to liken it to the case of a trustee. A trustee is a real person capable of being a citizen or an alien, who has the whole legal estate in himself. At law, he is the real proprietor, and he represents himself, and sues in his own right. But in this case the corporate name represents persons who are members of the corporation.

If the Constitution would authorize Congress to give the courts of the Union jurisdiction in this case, in consequence of the character of the members of the corporation, then the judicial act ought to be construed to give it. For the term citizen ought to be understood as it is used in the constitution, and as it is used in other laws. That is, to describe the real persons who come into court, in this case, under their corporate name.

That corporations composed of citizens are considered by the legislature as citizens, under certain circumstances, is to be strongly inferred from the registering act. It never could be intended that an American registered vessel, abandoned to an insurance company composed of citizens, should lose her character as an American vessel; and yet this would be the consequence of declaring that the members of the corporation were, to every intent and purpose, out of view, and merged in the corporation.

The court feels itself authorized by the case in 12 Mod. on a question of jurisdiction, to look to the character of the individuals who compose the corporation, and they think that the precedents of this court, though they were not decisions on argument, ought not to be absolutely disregarded.

If a corporation may sue in the courts of the union, the court is of opinion that the averment in this case is sufficient.

Being authorized to sue in their corporate name, they could make the averment, and it must apply to the plaintiffs as individuals, because it could not be true as applied to the corporation.

Judgment reversed; plea in abatement overruled, and cause remanded.

NOTE. — In *Strawbridge* v. *Curtiss*, 3 Cranch, 267, the Supreme Court decided that, where there are two or more joint plaintiffs and two or more joint defendants, each of the plaintiffs must be capable of suing each of the defendants in the federal courts, in order to support the jurisdiction. Strawbridge was a citizen of Massachusetts. One of the defendants was a citizen of Vermont; the other defendants were citizens of Massachusetts; and it was held that the federal court had not jurisdiction.

A logical application of the combined principles of *Strawbridge* v. *Curtiss* and *Bank* v. *Deveaux* was made in *Commercial Bank* v. *Slocomb*, 14 Pet. 60. The plaintiffs, citizens of Louisiana, brought an action in a federal court against a Mississippi corporation. The defendant pleaded that two of the members of the corporation were citizens of Louisiana, and it was held that, upon the facts thus pleaded, the court had not jurisdiction.

In *Louisville, Cincinnati, Etc., R.R. Co.* v. *Letson*, 2 How. 497, a citizen of New York brought a suit in a circuit court against a corporation of South Carolina, two shareholders in which were citizens of North Carolina. The statute provided that the circuit courts should have jurisdiction where "the suit is between a citizen of the State where the suit is brought, and a citizen of another State." The defendant contended that under this statute the court had no jurisdiction where the suit was by a citizen of one State against citizens of a second and a third State; and that the suit in question was such a suit. The court held that the circuit court had jurisdiction. Mr. Justice WAYNE said (p. 555): "After mature deliberation, we feel free to say that the cases of Strawbridge and Curtis and that of the Bank and Deveaux were carried too far, and that consequences and inferences have been argumentatively drawn from the reasoning employed in the latter which ought not to be followed. Indeed, it is difficult not to feel that the case of the Bank of the United States and the Planters' Bank of Georgia is founded upon principles irreconcilable with some of those on which the cases already adverted to were founded. The case of the Commercial Bank of Vicksburg and Slocomb was most reluctantly decided upon the mere authority of those cases. We do not think either of them maintainable upon the true principles of interpretation of the Constitution and the laws of the United States. A corporation created by a State to perform its functions under the authority of that State and only suable there, though

it may have members out of the State, seems to us to be a person, though an artificial one, inhabiting and belonging to that State, and therefore entitled, for the purpose of suing and being sued, to be deemed a citizen of that State. We remark too, that the cases of Strawbridge and Curtis and the Bank and Deveaux have never been satisfactory to the bar, and that they were not, especially the last, entirely satisfactory to the court that made them. They have been followed always most reluctantly and with dissatisfaction. By no one was the correctness of them more questioned than by the late chief justice who gave them. It is within the knowledge of several of us, that he repeatedly expressed regret that those decisions had been made, adding, whenever the subject was mentioned, that if the point of jurisdiction was an original one, the conclusion would be different. We think we may safely assert, that a majority of the members of this court have at all times partaken of the same regret, and that whenever a case has occurred on the circuit, involving the application of the case of the Bank and Deveaux, it was yielded to, because the decision had been made, and not because it was thought to be right. We have already said that the case of the Bank of Vicksburg and Slocomb, 14 Peters, was most reluctantly given, upon mere authority."

Marshall v. *Baltimore & Ohio R.R. Co.*, 16 How. 314. The plaintiff averred that he was a citizen of Virginia, and that the defendant was a corporation by the act of the General Assembly of Maryland. It was objected that this averment was insufficient to show jurisdiction in the federal court: The court held it was sufficient. Mr. Justice GRIER said (pp. 328, 329): "The persons who act under these faculties, and use this corporate name, may be justly presumed to be resident in the State which is the necessary *habitat* of the corporation, and where alone they can be made subject to suit; and should be estopped in equity from averring a different domicil as against those who are compelled to seek them there, and can find them there and nowhere else. . . . The presumption arising from the *habitat* of a corporation in the place of its creation being conclusive as to the residence or citizenship of those who use the corporate name and exercise the faculties conferred by it, the allegation that the 'defendants are a body corporate by the act of the General Assembly of Maryland' is a sufficient averment that the real defendants are citizens of that State."

St. Louis & San Francisco Ry. Co. v. *James*, 161 U.S. 545. The plaintiff below was a citizen of Missouri. The defendant was a Missouri corporation, which had been reincorporated as an Arkansas corporation. The action was brought in the federal court in Arkansas, and it was held that such court did not have jurisdiction. Mr. Justice SHIRAS said (p. 562): "To fully reconcile all the expressions used in these cases would be no easy task, but we think the following

propositions may be fairly deduced from them: There is an indisputable legal presumption that a state corporation, when sued or suing in a Circuit Court of the United States, is composed of citizens of the State which created it, and hence such a corporation is itself deemed to come within that provision of the Constitution of the United States which confers jurisdiction upon the Federal courts in 'controversies between citizens of different States.'

"It is competent for a railroad corporation organized under the laws of one State, when authorized so to do by the consent of the State which created it, to accept authority from another State to extend its railroad into such State and to receive a grant of powers to own and control, by lease or purchase, railroads therein, and to subject itself to such rules and regulations as may be prescribed by the second State. Such legislation on the part of two or more States is not, in the absence of inhibitory legislation by Congress, regarded as within the constitutional prohibition of agreements or compacts between States.

"Such corporations may be treated by each of the States whose legislative grants they accept as domestic corporations.

"The presumption that a corporation is composed of citizens of the State which created it accompanies such corporation when it does business in another State, and it may sue or be sued in the Federal courts in such other State as a citizen of the State of its original creation.

"We are now asked to extend the doctrine of indisputable citizenship, so that if a corporation of one State, indisputably taken, for the purpose of Federal jurisdiction, to be composed of citizens of such State, is authorized by the law of another State to do business therein, and to be endowed, for local purposes, with all the powers and privileges of a domestic corporation, such adopted corporation shall be deemed to be composed of citizens of the second State, in such a sense as to confer jurisdiction on the Federal courts at the suit of a citizen of the State of its original creation.

"We are unwilling to sanction such an extension of a doctrine which, as heretofore established, went to the very verge of judicial power. That doctrine began, as we have seen, in the assumption that State corporations were composed of citizens of the State which created them; but such assumption was one of fact, and was the subject of allegation and traverse, and thus the jurisdiction of the Federal courts might be defeated. Then, after a long contest in this court, it was settled that the presumption of citizenship is one of law, not to be defeated by allegation or evidence to the contrary. There we are content to leave it."

See also *Missouri Pacific Ry. Co.* v. *Castle*, 224 U.S. 541, 545.

In *Great Southern Fire Proof Hotel Co.* v. *Jones*, 177 U.S. 449, Mr. Justice HARLAN said (p. 456): "The rule that for purposes of

jurisdiction and within the meaning of the clause of the Constitution extending the judicial power of the United States to controversies between citizens of different States, a corporation was to be deemed a citizen of the State creating it, has been so long recognized and applied that it is not now to be questioned."

In *Northern Securities Co.* v. *United States*, 193 U.S. 197, Mr. Justice Brewer spoke (p. 362) of a corporation as "by fiction of law recognized for some purposes as a person and for purposes of jurisdiction as a citizen."

In *Doctor* v. *Harrington*, 196 U.S. 579, the plaintiffs, citizens of New Jersey, as shareholders in a New York corporation, brought suit in a federal court against the corporation and certain other defendants who were citizens of New York. It was contended that the plaintiffs must be presumed to be citizens of New York and therefore that the court was without jurisdiction. This contention was not upheld.

Washington Insurance Co. v. *Price*, 1 Hopkins, Chancery Reports (N.Y.) 1. The statute provided that "where the chancellor shall be a party to a suit in chancery, the bill shall be filed before the Chief Justice of the State." The chancellor was a shareholder in a corporation which filed a suit in chancery. He declined to determine the suit: "The chancellor is a party to a suit in this court by or against a corporate company, in which he is a stockholder. . . . The Chief Justice has jurisdiction of such suits." Cf. *Stuart* v. *Mechanics' Bank*, 19 John (N.Y.) 496, 501.

UNITED STATES *v.* MILWAUKEE REFRIGERATOR TRANSIT CO.

142 Fed. 247. 1905.

Sanborn, District Judge. This is a bill in equity for an injunction to prevent the payment of alleged rebates on freight, brought under Elkins Act, February 19, 1903, c. 708, 32 Stat. 847 [U.S. Comp. St. Supp. 1905, p. 599]. The defence outlined in argument of the demurrers is that it appears on the face of the bill that the alleged rebates were not paid back to the shipper (the brewing company), but to the Refrigerator Transit Company, and, in substance and effect, nothing more is shown than the payment to a soliciting agent (the transit company) of a commission of an eighth or tenth of the published tariff rates, thus showing, in real effect, acts neither unlawful, immoral, nor injurious. A motion is also made on behalf of the brewing company to strike out certain allegations averring prior and disconnected illegal acts on its part, said to be material in proof, to characterize the acts of its principal officers and managers in organizing

the transit company, and rebut the theory that the moneys paid by the carriers to the transit company were paid as commissions for obtaining the business and not as prohibited rebates.

The provisions of section 10 of the Interstate Commerce Act, the Act of 1889 (Act March 2, 1889, 25 Stat. 857 [U.S. Comp. St. 1901, p. 3160]), and the Elkins Act, may be thus summarized: —

Section 10, Interstate Commerce Act.

Common carriers, and the officers of such as are corporations, receivers, agents, etc., of such corporations, are prohibited from giving rebates, preferences, and advantages, and making unjust discriminations, and are punishable by fine and imprisonment. Under this section only the agents of corporate carriers, and not the carriers themselves, were punishable. *U.S.* v. *Mich. Cent. R. Co.*, (D. C.) 43 Fed. 26.

Act of 1889.

Agents of carriers: Any common carrier, and officers and agents of corporation carriers, who by means of false billing, classification, weighing, or other device or means, shall assist, suffer, or permit any one to obtain transportation at less than established rates, shall be guilty of a misdemeanor, punishable by fine and imprisonment.

Shippers: Any person or corporation agent shipping property, who shall knowingly, by false billing, classification, etc., or other device or means, with or without the carrier's consent or connivance, obtain carriage at less than such established rates, shall be deemed guilty of fraud, declared to be a misdemeanor, punishable by fine and imprisonment.

Bribery to obtain unjust discrimination: Any such person, officer, etc., who shall by paying money or thing of value, or by solicitation, induce a carrier to discriminate unjustly in his favor as against other shippers, or aid or abet such discrimination, shall be deemed guilty of a misdemeanor, punishable by fine and imprisonment.

Tort action: Shippers discriminated against are given action for damages against such person, officer, etc., as well as the carrier.

Corporation carriers themselves, it will be noticed, are not within the penalties of these acts; and the defence that the supposed discrimination was made not under like circumstances and conditions was always available.

Elkins Act of 1903.

Corporation carriers are made liable to the same extent as were their agents under the earlier statutes, but subject to fine only, not imprisonment. Their wilful failure to publish tariffs or rates, or strictly observe them, is a misdemeanor punishable by fine. It is made unlawful and punishable for any person or corporation to offer,

grant, or give, or to solicit, accept, or receive, or offer so to do, any rebate, concession, or discrimination in respect of transportation in interstate or foreign commerce by common carriers within the former statutes, whereby any such property shall, by any device whatever, be carried at less than the published tariff rate. Offences under the earlier acts, followed by convictions after this act, are punishable only by fine. The acts or omissions of agents are deemed the acts or omissions of the carrier also. The published rate is made conclusive, and any departure therefrom punishable. Suits in equity by the commission, as well as those directed by the Attorney-General, are authorized, and the provisions of the expedition act and anti-trust act are made applicable. It will be observed that this act makes the corporation carriers themselves liable, eliminates the question of like circumstances and conditions by making the published rate conclusive, and abolishes punishment by imprisonment.

In effect the bill in this case is claimed to charge the creation by a shipper of a dummy corporation as a device to cover rebates on large shipments of beer in interstate and foreign traffic. The carriers which are charged with paying the rebates are joined as defendants, and some of them have filed general demurrers for want of equity in the bill. The Pabst Brewing Company has also moved to strike out the following paragraph: —

"That until the passage and promulgation of the act of Congress entitled 'An act to further regulate commerce with foreign nations and states,' approved February 19, 1903, said defendant Pabst Brewing Company had, through the agency of said Gustav G. Pabst and Frederick Pabst, habitually received from many of the railroads and common carriers, which so transported the beer and other articles so shipped by it from the State of Wisconsin into foreign countries and states other than Wisconsin, rebates and concessions and other discriminations."

The bill, after stating that the Pabst Brewing Company, Milwaukee Refrigerator Transit Company, and Wisconsin Central Railway Company are Wisconsin corporations, and the other defendants foreign corporations, that the Attorney-General has directed these proceedings, that the shipments originate in Milwaukee and continue in other states and countries, contains the following allegations, here given in brief outline (the figures refer to the numbered paragraphs of the bill): —

(11) The transit company was, on October 7, 1903, organized, *inter alia*, to operate refrigerator cars on defendants' and other lines. It owns or controls 540 such cars. It was conceived, and is operated, as defendants' carriers well knew, as a device to cover the receiving of rebates, concessions, and discriminations, to wit, an eighth or tenth of the published rate; whereby the traffic is carried at less than published rates. Such rebates are paid and accepted under the pre-

tence, claim, and guise of "commissions," and amount to large sums to complainants unknown.

(12) The transit company was incorporated by procurement of the attorneys of the brewing company, and at its instance and request, with a capital of $150,000, having five directors, and with power to acquire and operate refrigerator cars, and contract for the supply and operation of refrigerator transportation by land and water.

(13) The brewing company is a Wisconsin corporation operating a large brewery, and selling and shipping beer into all the states and territories and to purchasers in foreign countries. It has a capital of $10,000,000 or 10,000 shares. Gustav Pabst and Fred Pabst are brothers, owning 2000 shares, and with their mother and sisters over half of the stock. They vote and control a majority of the stock, and have always directed and controlled the election of directors, and their action; they have been and are its president, vice-president, and general managers, and have always controlled all its sales, purchases, and shipments.

(14) (Here occurs the passage above quoted as to rebates prior to the Elkins Act.) Upon the passage of that act the brewing company was no longer able to directly secure rebates, and cast about for some device to evade the statute, and the Pabsts, as such officers, and one Howe, as traffic manager, intending to contrive and operate a device for such evasion, caused the transit company to be formed. Of its 1500 shares, 1340 were issued to the two Pabsts, 35 shares to Fred Pabst's wife, and the balance to dummy directors, to give color to the claim that its stock was not owned by the brewing company. After investigation by the interstate commerce commission in May, 1905, Gustav Pabst transferred his stock in the transit company to Fred Pabst, and had some person elected director in his place; but such acts were colorable merely, he still retaining a large pecuniary interest in the corporation, and participating in its control.

(15) Immediately on the creation of the transit company the Pabsts, as controlling officers of the brewing company, contracted with themselves as executive officers of the transit company, for a term not yet expired, to give the latter exclusive control of the shipment of all freight of the brewing company moving in interstate and foreign commerce, which it is still exercising. The contract was made to enable the transit company to route the shipment of such freight on the lines of such companies as will pay rebates, and withhold it from such as will not; and all the rebates, concessions, and discriminations charged in the bill have been exacted by threats of such diversion. Many thousand tons of said freight have been hauled by defendant carriers since the contract was made. On such shipments the brewing company pays to the carriers the full tariff rate, and the carriers pay the transit company for use of its refrigerator cars for mileage three fourths of a cent to a cent per mile, and in addition

an eighth or tenth of the sums paid them by the brewing company; and in every instance the property is transported by defendant carriers at an eighth or tenth less than the published tariff. Such rebates amount to many thousands of dollars, the exact sum unknown to complainants.

(16) All the defendant carriers well knew that the transit company was organized in the interest of the brewing company, and for the purpose of evading the law, and paid such rebates with the like purpose and intent.

(18) The transit company claims and pretends that such repayments were made and accepted as compensation for its services in soliciting and procuring freight for carriage by defendants; but such claim or pretence is untrue. The transit company has entire control of all the shipping business of the brewery, comprising almost the entire business of the transit company, which it does not solicit; the only possible consideration moving from it to the carrier being its refraining to divert the business. All such repayments have always been known to all said parties to be a device for unlawful rebate, concession, and discrimination. But such payments constitute unlawful concession and discrimination, whether or not the transit company solicits the shipments, which, if not so solicited and procured, would be diverted from the carrier so paying.

[After disposing of another point.] It is further essential, to bring the case within the law, that the repayments be made to the brewing company, or for its benefit, directly or indirectly, and not merely to third persons for obtaining the business; otherwise the repayment is no more than a salary or other expense incident to the carrier's business. The remaining question, then, is whether this is sufficiently shown in the bill. It is forcibly argued that the bill carefully avoids the statement that the brewing company received the money repaid, or even that it was paid back for its benefit; and that the two corporations are not only distinct legal entities, but have different stockholders. The bill shows the creation, by the controlling interests of the brewing company, of a dummy corporation, with dummy directors, and *scienter* of its character by the carriers, with intent to evade the law. It is argued that these averments show that the transit company is merely the *alter ego* of the brewing corporation; both being substantially identical in interest and control, and the brewing company the ultimate beneficiary, in some form, of the operations in question. Now is not this the usual device of a shipper securing discrimination by manipulation of carriers in which it is interested?

That the transit company is controlled by the managing agents of the brewing company is entirely clear. But is it controlled by the shipper corporation? The solution of this question depends on whether the brewing corporation, in a case like this, is an association

of individuals, rather than a legal entity apart from those who own and control it. No doubt the general rule that a corporation is a legal entity, an institution, artificial, intangible, existing only by legal contemplation, and separate and apart from its constituents, is firmly imbedded in the common law of this country. It has been so laid down in hundreds of cases. In the *Dartmouth College Case,* Chief Justice MARSHALL adopted and expressed it, almost in the exact language of Lord Coke, in Coke on Littleton, 27b; and this definition has been universally approved, especially in cases involving the extent of the corporate powers.

It is, however, most significant that the Supreme Court of the United States was the first to break away from the notion that a corporation is only a legal entity, when its literal application would operate with injustice. If a corporation is only a legal entity, of course it cannot be a citizen of a state. Hence the Supreme Court, in order to sustain the most important and far-reaching jurisdiction of the national courts over corporations, depending on the citizenship of the parties, was obliged to adopt some other theory of corporate constitution than that laid down by the great chief justice. This was accomplished by holding that a corporation is an association of persons who may have citizenship, and following this with the adoption of a fiction of law, supported by a conclusive presumption, by which the members of a corporation are conclusively presumed to be citizens of the state creating it. *Hope Ins. Co.* v. *Boardman,* 5 Cranch, 57, 3 L. Ed. 36; *Louisville, etc., R. Co.* v. *Letson,* 2 How. 497, 11 L. Ed. 353; *Marshall* v. *R. Co.*, 16 How. 314, 14 L. Ed. 953. In reaching these results, the court, in answering the argument that a corporation is an artificial person, a mere legal entity, invisible and intangible, said that it was not reasonable that those who deal with corporate affairs or agents should be deprived of the valuable privilege of litigating in the federal courts by a syllogism, or rather sophism which deals subtly with words and names, without regard to the things or persons they are used to represent. 16 How. 327, 14 L. Ed. 953. "For all purposes of acting, contracting, and judicial remedy," said Mr. Justice GRIER, "they can speak, act, and plead only through their representatives or curators." Id. Thus the idea that a corporation is, for some purposes, an aggregation of individuals, and not a legal entity, was adopted, through a fiction of law, and given full effect. It was the same kind of fiction by which the English Court of Exchequer usurped jurisdiction by permitting an allegation that plaintiff was the king's debtor, and then allowing no one to deny it.

But when the case of a consolidated corporation incorporated in two or more states, having the same stockholders, arose, the Supreme Court partially returned to the rule that a corporation is a legal entity, existing only in contemplation of law. And it was held

that there are as many corporations as there are states in which the same group of persons is incorporated. In each of such states it is conclusively presumed that the shareholders are, for jurisdictional purposes, citizens of that state alone. Hence, a citizen of Illinois cannot in Illinois sue in a federal court the Chicago & Northwestern Railway Company, consolidated by incorporation in both Illinois and Wisconsin; but he may do so in Wisconsin. *Railroad Co.* v. *Wheeler*, 1 Black, 286, 17 L. Ed. 130; *Railway Co.* v. *Whitton*, 13 Wall. 270, 283, 20 L. Ed. 571. This result was reached by applying the rule that the legal entity existing by force of law can have no existence beyond the state or sovereignty which brings it into life and indues it with its faculties and powers. Id. "It is true that for certain purposes the law will recognize the corporation as an entity distinct from the individual stockholders; but that fiction is only resorted to for the purpose of working out the lawful objects of the corporation. It is never resorted to when it would work an injury to any one, or allow the corporation to perpetrate a fraud upon anybody." Held that stock in one corporation directed by another corporation to be issued to the stockholders of the latter, and paid for by it, was in reality received by the corporation. *The Sportsman Shot Co.* v. *American Shot & Lead Co.* (Superior Court of Cincinnati) 30 Wkly. Law Bul. 87; *State* v. *Standard Oil Co.*, 49 Ohio St. 137, 177, 30 N.E. 279, 15 L. R. A. 145, 34 Am. St. Rep. 541. "The abstract idea of a corporation, the legal entity, the impalpable and intangible creation of human thought, is itself a fiction, and has been appropriately described as a figure of speech. It serves very well to designate in our minds the collective action and agency of many individuals as permitted by the law; and the substantial inquiry always is what in a given case has been that collective action and agency?" *People* v. *North River Sugar Refining Co.*, 121 N.Y. 582, 621, 24 N.E. 834, 9 L. R. A. 33, 18 Am. St. Rep. 843. "A corporation is an artificial person, created by law as the representative of those persons, natural or artificial, who contribute to and become the holders of shares in the property intrusted to it for a common purpose. . . . It is exclusively the work of the law." *In re Gibb's Estate*, 157 Pa. 59, 27 Atl. 383, 22 L. R. A. 276, 281. "Corporations are but associations of individuals." *Hightower* v. *Thornton*, 8 Ga. 492, 52 Am. Dec. 412; 1 Kyd on Corp. 13. "Who, in law, constitute the company, if it be not the stockholders?" *Gelpcke* v. *Blake*, 19 Iowa, 268. "A private corporation is, in fact, but an association of individuals united for a lawful purpose and permitted to use a common name in their business, and to have a change of members in their business." FIELD, J., in *Kansas Pacific* v. *Atchison Railroad*, 112 U.S. 414, 5 Sup. Ct. 208, 28 L. Ed. 794. On the other hand, when dealing with the question of corporate power, the Supreme Court has gone so far as to hold that a contract *ultra vires* of the corporation,

although assented to by all the stockholders, is void. *Oregon Railway & Navigation Co.* v. *Oregonian Ry. Co.*, 130 U.S. 1, 9 Sup. Ct. 409, 32 L. Ed. 837.

A stockholder owning nearly all the stock cannot bind the corporation by a contract made in his individual capacity. *Donoghue* v. *I. & L. M. Ry. Co.*, 87 Mich. 13, 49 N.W. 512; *Finley Shoe & Leather Co.* v. *Kurtz*, 34 Mich. 89; *England* v. *Dearborn*, 141 Mass. 590, 6 N.E. 837. It seems that an act of all the stockholders, as individuals, binds the corporation, as no one can object. *Bundy* v. *Iron Co.*, 38 Ohio St. 300 (mortgage by all but one stockholder, to the remaining one, of corporate property, executed in the individual names of the stockholders, held valid). A corporation, from one point of view, may be considered an entity, without regard to its shareholders, yet the fact remains self-evident that it is not in reality a person or thing distinct from its consistent parts. The word corporation is but a collective name for the members who compose the association. *Home Fire Ins. Co.* v. *Barber* (Neb.) 93 N.W. 1024, 60 L. R. A. 927; *City of Nashville* v. *Ward*, 16 Lea, 27; *People* v. *North River, etc., Co.* (Sup.) 3 N.Y. Supp. 401, 2 L. R. A. 33; *Ford* v. *Chicago Milk Shippers' Ass'n*, 155 Ill. 166, 39 N.E. 651, 27 L. R. A. 298; *First Nat. Bk.* v. *Trebein Co.*, 59 Ohio St. 316, 52 N.E. 834; *Buffalo Loan, etc., Co.* v. *Medina Gas, etc., Co.* (Sup.) 42 N.Y. Supp. 781. If any general rule can be laid down, in the present state of authority, it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons. This much may be expressed without approving the theory that the legal entity is a fiction, or a mere mental creation; or that the idea of invisibility or intangibility is a sophism. A corporation, as expressive of legal rights and powers, is no more fictitious or intangible than a man's right to his own home or his own liberty.

Applying the rule here laid down to the circumstances shown to surround the brewing company and transit company, can it be doubted that there really is, in substance and effect, an identity of interest, or that the brewing company, considered as an association of individuals, really owns and fully controls the transit company? Or that the payment of the eighth or tenth of the rate is in reality, and in some form, a payment to, or for the benefit of, the shipper? I think sufficient is alleged to show this. Moreover, it clearly appears that the shipper practically controls the transit company, and I think this shows a sufficient identity of interest among the shareholders of both in these repayments to make them rebates, if paid and received with unlawful intent. It is said that the procurement of the shipments through the contract is the mere soliciting of them for

the carriers, for which they are lawfully authorized to pay a part of the rate, in order to get the business; and the transit company, owning a large number of refrigerator cars, and wishing to keep them employed, simply gives the freight to those competing shippers who will make the best terms, the business being of great volume, and the sums paid for freights large. But this theory of innocence is exploded by the fact, as alleged (whatever the actual proof may show), that the transit company is a mere separate name for the brewing company, being in fact the same collection of persons and interests. Assuming the truth of the averments, the device adopted is "neither new, nor deserving of new success." As the patent lawyers say of an aggregation, there is no new mode of operation, new use, or new result — simply the use of old things in a different situation.

There is, no doubt, some tendency in these days to accept general and vague charges of wrong-doing on the part of the corporations at a premium. Much has happened to arouse public feeling on this sensitive subject. For many years transportation development was encouraged in every possible way. The municipal aid craze was an early form of such stimulation. Praise for those who were seeking command of the trade of the world was unstinted and without dissent, and criticism forgotten. But now that we are beginning to feel the tyranny of arbitrary and overwhelming industrial and commercial power, the tendency is to go to the other extreme, and it becomes easy to excite prejudice leading to injustice. The courts will no doubt be somewhat influenced by such tendency; but so far as possible it is for them to keep fundamental rules steadily in view, and with discrimination and careful reflection see to it that injustice is prevented. Joseph Cooke once facetiously said that he had never travelled in Pennsylvania, but had often visited the domains of the Pennsylvania Railroad Company. These and other like domains are now subject to widespread attack; but it will not be forgotten that they are our domains, and, if they are being despoiled, the spoliation is the work of our trustees, who must indeed be brought to book, but the trust property at the same time preserved.

NOTE. — *United States* v. *Delaware & Hudson Co.*, 213 U.S. 366. The Hepburn Act (Act of June 29, 1906, c. 3591, 34 Stat. 584) made it unlawful for any railroad company to transport, in interstate commerce, "any article or commodity, other than timber and the manufactured products thereof, manufactured, mined, or produced by it, or under its authority, or which it may own in whole or in part, or in which it may have any interest direct or indirect." It was held (p. 413) that this did not make it unlawful for the railroads to transport commodities owned "by a *bona fide* corporation in which the transporting carrier holds a stock interest." But in *United States* v. *Lehigh Valley R.R. Co.*, 220 U.S. 257, the court held that it was open

to the Government to question the right of a railroad company to transport commodities of a corporation in which the company owns stock and uses its power as a stockholder to obliterate all distinctions between the two corporations.

Enos v. *Hanff*, 95 Neb. 184. By chapter 82 of the Laws of Nebraska for 1907 it was made unlawful to conduct a saloon in a building owned or controlled by a manufacturer of beer. The Storz Brewing Company, a manufacturer of beer, transferred a building to the Independent Realty Company, and a license to sell liquors in such building was granted by the municipal authorities authorized to issue licenses. Gottlieb Storz owned 3061 out of 3065 shares of the stock of the Storz Brewing Company. His wife owned 3058 out of 3060 shares of the stock of the Independent Realty Company. The court held that the license should not have been granted, as the building was controlled by the Storz Brewing Company, saying (p. 187): "Where the financial interests of husband and wife are thus united, the court, in furtherance of a public policy established by the legislature, will look beyond the legal entity of a corporation to the relations of the individuals behind it and enforce the law according to its terms." But the court, on rehearing, reversed this decision (152 N.W. 397). The court said that if the Storz Brewing Company organized or promoted the Realty Company and transferred the property for the purpose of enabling the brewing company to continue to control it for the purpose of leasing it as a saloon, there could be no doubt that the company so formed would be for an illegal purpose, and might be dissolved by *quo warranto;* this question, however, was not one which the licensing authorities were fitted to pass upon. "The licensing board may exercise its discretion, and is not required to grant a license if a doubt is entertained as to the good faith in the proceedings in any respect. On the other hand, it seems clear that the Legislature never intended that the licensing board should be compelled to enter upon such investigations as are suggested by this objection."

Northern Securities Co. v. *United States*, 193 U.S. 197, is considered, *infra*, in the chapter on Offenses under the Sherman Anti-Trust Act.

BANK *v.* TREBEIN.

59 Ohio St. 316. 1898.

Minshall, J. We are unable to see how, as against his creditors, the transaction by which F. C. Trebein, with his wife, his daughter, his son-in-law, and his brother-in-law, formed "The F. C. Trebein Company" and then conveyed to it every vestige of property he had not before conveyed, either to his wife or to his daughter, can be sus-

tained, against the justice of their demand to have the property so transferred administered for the benefit of all his creditors under the insolvent laws of this state. He was at the time liable in a large sum of money on indorsements he had made for the accommodation of the Straw Paper Company, of which he was a member and one of its directors. He knew it was about to fail and that he would have to respond to these indorsements. This fact induced the conveyances he had before made to his wife and to his daughter, whether for a valid consideration or not, was not considered by the court for the reasons stated in its finding, that there were suits then pending to set them aside. The capital of The F. C. Trebein Company was fixed at $60,000, divided into 600 shares of $100 each, Trebein taking 596 of the shares and each of the other persons named taking *one* share. It was formed on January 22, 1895, Trebein being made the president, treasurer, and general manager, and he conveyed to the company the property in question, estimated to be worth $60,000, and received therefor the shares above stated, and at once placed all of them, except one, in pursuance of his original purpose, with three of the banks who held his indorsements of the paper of the Straw Paper Company, for the purpose of securing them on his indorsements; and he continued in the control and management of the milling and grain business as he had before the corporation was formed and the conveyance made. The court found that this was all done in good faith. But, in view of the facts, we are unable to see how the court could have meant more than that he meant no wrong by it. Good faith in law, however, is not to be measured always by a man's own standard of right, but by that which it has adopted and prescribed as a standard for the observance of all men in their dealings with each other. When one conveys all his property to another with the intention of hindering and delaying his creditors, or a part of them, in pursuing their legal remedies against him and his property, his conduct in law is deemed fraudulent, however honestly he may have intended to deal with all his creditors in the future. *Trimble* v. *Doty*, 16 Ohio St. 118. The good faith of a party under such circumstances must be determined by the legal effect of what he deliberately does. *Brinkerhoff* v. *Tracy*, 55 Ohio St. 558; *Lee* v. *Hennick*, 52 Ohio St. 177; *Gashe* v. *Young*, 51 Ohio St. 376, 389. The formation of the corporation and the conveyance to it by Trebein of all the property he then had, necessarily hindered and delayed all his creditors in the pursuit of their claims against him. The formation of the corporation in no way facilitated the transaction of his milling business and that connected with it. Nothing was added to his capital, unless we regard the few hundred dollars that may have been paid for the four shares of stock taken by the other members of his family such an addition. Evidently an addition to capital was not the controlling object. The transaction cannot be likened to a conveyance to a third person

for a valuable consideration; considered in the light of the facts, it was no more than a conveyance from himself to himself. The corporation was in substance another F. C. Trebein. His identity as owner of the property was no more changed by his conveyance to the company than it would have been by taking off one coat and putting on another. He was as much the substantial owner of the property after the conveyance as before; and had substantially the same use of it as if the conveyance had not been made. The only purpose the creation of the corporation and the conveyance to it subserved, was to hinder creditors in levying upon the property and selling it on execution at law; and it is this hindrance the law will not permit, and, when ascertained in a proper proceeding, requires the conveyance to be set aside and the property administered for the benefit of all the creditors of the fraudulent grantor.

It is suggested that the property may be levied on. This is true, but it cannot be sold on execution until the conveyance is set aside; for it is not the policy of the law to sell a law suit. It is also suggested that the stock of Trebein may be reached by a proceeding provided by statute. This is true, but it is not the simple proceeding of an execution at law; besides few persons, at this day, would care to take stock in a manufacturing or any similar company, with its statutory liability attached, as a substitute for tangible property.

The fiction by which an ideal legal entity is attributed to a duly formed incorporated company, existing separate and apart from the individuals composing it, is of such general utility and application, as frequently to induce the belief that it must be universal, and be in all cases adhered to, although the greatest frauds may thereby be perpetrated under the fiction as a shield. But modern cases, sustained by the best text writers, confine the fiction to the purposes for which it was adopted — convenience in the transaction of business and in suing and being sued in its corporate name, and the continuance of its rights and liabilities, unaffected by changes in its corporate members; and have repudiated it in all cases where it has been insisted on as a protection to fraud or any other illegal transaction. Thus in *Brundred* v. *Rice*, 49 Ohio St. 540, where an incorporation had been formed for the purpose of giving effect to an illegal agreement between it and a railroad company for a discrimination in freights between it and other shippers, the fiction was disregarded, and a recovery allowed against the promoters by one who had been thus discriminated against, in like manner as if the corporation had no existence. See also the following citations: Morawetz on Corporations, §§ 1 and 227; *Railway Co.* v. *Miller*, 51 N.W. 981; *Gas Company* v. *West*, 50 Iowa, 16; *Booth* v. *Bunce*, 33 N.Y. 139; *State ex. rel. Atty.-Gen.* v. *Standard Oil Co.*, 49 Ohio St. 137; *Bennett* v. *Minott*, 28 Oregon, 339, 348.

In *Montgomery Web Co.* v. *Dienelt*, 133 Pa. St. 585, which was a

suit by a creditor of one company to set aside a conveyance by it to another, as in fraud of his rights, it appeared that the latter was formed substantially by the stockholders of the former, who relinquished their stock in it for stock in the latter; this being substantially all the consideration given by the purchasing company. This was held to be a fraud on the creditors of the former company, called the Aronia. The case does not differ in principle from the one before us. Here the conveyance was by an individual, and in consideration of stock taken in the corporation formed. The judge, delivering the opinion, said: "Is the Montgomery Company so completely a new and different company from the Aronia Company that the law must close its eyes to the fact that the difference is a mere jungle of names? We do not think there is any compulsion to such legal blindness. Settled general principles, and the analogies of the law, are against such a contention. If the corporation had merely changed its name, there could have been no doubt of the continued liability of the property."

Judgment reversed.

NOTE. — See, *accord*, *Kellogg* v. *Douglas Co. Bank*, 58 Kan. 43; *Bennett* v. *Minott*, 28 Or. 339.

Gonville's Trustee v. *Patent Caramel Co., Ltd.*, [1912] 1 K.B. 599. A conveyance of property by A, a failing debtor, to a company, formed by himself and a confederate to receive the property, was set aside on the ground that the company, through its directors, knew that the conveyance was intended to hinder the creditors of A. The court did not speak of disregarding the corporate fiction. See also *In re David & Adlard*, [1914] 2 K.B. 694.

In *Noble* v. *Burnett Co.*, 208 Mass. 75, the court said (p. 83): "The corporation was not a purchaser without notice. The officers and organizers were members of the firm, and they held nearly all the stock. Their knowledge was the knowledge of the corporation."

PEOPLE *v.* NORTH RIVER SUGAR REFINING CO.

121 N.Y. 582. 1890.

THIS action was brought by the attorney-general to have the defendant "dissolved, its charter vacated and its corporate existence annulled."

The complaint alleged, and it was found, that defendant is a corporation organized under the General Manufacturing Act; that it, together with other corporations engaged in the business of sugar refining, in violation of law and in abuse of its powers, became a party to and carried out a certain agreement. Some of the material features of this agreement are, in substance, as follows: —

All the shares of the capital stock of all the corporations shall be transferred to a board consisting of eleven persons.

In lieu of the capital stock of each corporation, certificates not exceeding $50,000,000 shall be issued by the board, and allotted in certain proportions to the respective corporations. 15 per cent of the certificates thus allotted to each corporation shall be left with the board; the remaining 85 per cent shall be divided among the former stockholders in proportion to the amount of stock formerly owned by each.

The board of eleven persons, holding all the stock of all the corporations, may transfer shares to persons whom it may desire should be constituted directors of such corporations.

The several corporations shall maintain their separate organizations, and each shall carry on and conduct its own business.

The profits arising from the business of each corporation shall be paid over by it to the board hereby created, and the aggregate of said profits, or such amount as may be designated for dividends, shall be proportionately distributed by said board, at such times as it may determine, to the holders of the certificates issued by said board for capital stock.

No action shall be taken by the board which shall create liability by it or by its members.

The certificates retained by the board (15 per cent of the entire issue) shall be subject to be disposed of by the board either for the acquisition of other refineries to become parties to this agreement, payment for additional capacity, or by appropriations to the several refineries.

The funds necessary to enable the board to make the payments herein provided to be made by it may be raised by mortgage to be made by the corporations, or either, any, or all of them, on their property, and by such other means as shall be satisfactory to such board.

Vacancies in the board by expiration of office shall be filled at an annual meeting of the holders of certificates, at which said holders shall vote according to the number of shares for which they hold certificates.

FINCH, J. The judgment sought against the defendant is one of corporate death. The State, which created, asks us to destroy; and the penalty invoked represents the extreme rigor of the law. Its infliction must rest upon grave cause, and be warranted by material misconduct. The life of a corporation is indeed less than that of the humblest citizen, and yet it envelopes great accumulations of property, moves and carries in large volume the business and enterprise of the people, and may not be destroyed without clear and abundant reason. That would be true even if the legislature should debate the destruction of the corporate life by a repeal of the corporate charter:

but is beyond dispute where the State summons the offender before its judicial tribunals, and submits its complaint to their judgment and review. By that process it assumes the burden of establishing the charges which it has made, and must show us warrant in the facts for the relief which it seeks.

Two questions, therefore, open before us: first, has the defendant corporation exceeded or abused its powers; and, second, does that excess or abuse threaten or harm the public welfare.

The first question requires us to ascertain what the defendant corporation has done in violation of its duty, or omitted to do in performance of its duty. We find disclosed by the proof that it has become an integral part and constituent element of a combination which possesses over it an absolute control, which has absorbed most of its corporate functions, and dictates the extent and manner and terms of its entire business activity. Into that combination, which drew into its control sixteen other corporations engaged in the refining of sugar, the defendant has gone, in some manner and by some process, for as an unquestionable truth we find it there. All its stock has been transferred to the central association of eleven individuals denominated a "Board;" in exchange it has taken and distributed to its own stockholders certificates of the board carrying a proportionate interest in what it describes as its capital stock; the new directors of the defendant corporation have been chosen by the board, made eligible by its gift of single shares, and liable to removal under the terms of their appointment at any moment of independent action. It has lost the power to make a dividend, and is compelled to pay over its net earnings to the master whose servant it has become. Under the orders of that master it has ceased to refine sugar, and by so much, has lessened the supply upon the market. It cannot stir unless the master approves, and yet is entitled to receive from the earnings of the other refineries, massed as profits in the treasury of the board, its proportionate share for division among its own stockholders holding the substituted certificates. In return for this advantage it has become liable to be mortgaged, not for its own corporate benefit alone, but to supply with funds the controlling board when reaching out for other and coveted refineries. No one can look these facts fairly in the face without being compelled to say that the defendant is in the combination and in to stay. Indeed, so much is with great frankness admitted on the part of the appellant. Its counsel concedes that the stock was transferred "to the board mentioned in the agreement and on the terms and for the purposes mentioned in the agreement; and that this action effectually lodged the control of the defendant company, so far as such control can be secured by the voting power, in that board."

But that truth does not alone solve the problem presented. We are yet to ascertain whether the corporation became the subordinate

and servant of the board by its own voluntary action, or the will and power of others than itself; by force of a contract to which it was in reality a party, or as the simple consequence of a change of owners; by its fault or its misfortune; by a sale or by a trust. For, if it has done nothing, if what has happened, and all that has happened, is ascertained to be that the stockholders of the defendant, one or many, sold absolutely to the eleven men who constituted the board their entire stock, and the latter, by force of their proprietorship and as owners, have merely chosen directors in their own interest, and are only managing their property in their own way as any absolute owners may; if that is the truth, and the entire and exact truth, it is difficult to see wherein the corporation has sinned, or what it has done beyond merely omitting for a time to carry on its business. That is the theory upon which the appellant stands, and which it submits to our examination.

On the other hand it is contended that there never was a sale, but a trust constituted by mutual agreement; that they who agreed were the whole body of stockholders in each corporation necessarily representing and binding the corporation itself; that they transferred their shares to the board upon the trusts declared in the deed; that the certificates issued by the board were the formal declaration of the trust; that the corporate stockholders parted with the legal title of their stock to the chosen trustees with the power to vote upon it, but retained, nevertheless, its beneficial ownership through the operation of the certificates; and so the corporations entered into a partnership with each other, vesting the partnership power in a board of control.

I have brought these two theories face to face where they may confront each other, because, when a choice is made between them, we have gone a long distance towards the end of the controversy.

[The court held that the transaction was not a sale, but a trust constituted by mutual agreement.]

The combination, therefore, framed by the deed was a trust, and, if created by the corporations, or in any respect the consequence or product of their action, some inevitable results would be certain to follow. But here we encounter the stronghold of the appellant's argument which is, that if the corporations are in some manner in the combination, they are there solely as the result of a contract other than their own; are there without corporate action on their part; and so are sufferers and not sinners. The reasoning leading to that result is so severely technical as to have suggested a justification almost reminding one of an apology. We are called upon to sever the corporation, the abstract legal entity, from the living and acting corporators; as it were, to separate in our thought the soul from the body, and admitting the sins of the latter to adjudge that the former remains pure. Let us first recall the facts in the order of their occurrence.

[The court here recapitulated the facts; which were, in substance, that the stockholders unanimously directed the secretary to sign the agreement in behalf of the corporation; that he accordingly did so sign; that a subsequent vote to revoke this action was ineffective; that, at a later date, the stockholders voted to sell all the stock to John E. Searles, Jr., for $325,000; that the stock was so conveyed to Searles; and that Searles thereafter conveyed all the stock to the board of eleven persons receiving therefor certificates for $700,000; deducting the 15 per cent retained by the board. The opinion then proceeds:]

What Searles did with the certificates, we do not know, nor is it important to ascertain. We do know that new directors were chosen by the vote of the board; that Searles became President of the corporation; that its share of the regular dividend has been allotted to it for its certificate holders, and that it has wholly ceased to refine sugar. And thus its baptism in the pool of the board became complete and final.

And yet it is argued that the corporation, the legal entity, has done nothing; that Searles was guilty, but the corporate robe that enveloped him was innocent, and so he must be left to wear it undisturbed; that while all that was human and could act had sinned, yet the impalpable entity had not acted at all and must go free. I believe that the history of what occurred, as I have already described it, furnishes a sufficient answer, assuming that stockholders and trustees acting together can do a corporate act at all. There *was* corporate action in making the combination agreement which bound the defendant. The revocation of an executed authority left the contract standing. The corporation thus helped to make the trust and became an element of it. If there was anything imperfect in its action, the new stockholder and his associates waived the imperfection by acting upon the agreement of the corporation, and so confirming it in all particulars.

But the assumption underlying the view I have expressed is itself contested, and a proposition asserted which denies the possibility of any corporate action, except by the trustees or directors acting formally as such; a proposition which, if sound, dominates the whole field of controversy, and, establishing that there has been no corporate action at all, effectually shuts out every question of illegality or public injury. I cannot admit that proposition. I think there may be actual corporate conduct which is not formal corporate action; and where that conduct is directed or produced by the whole body, both of officers and stockholders, by every living instrumentality which can possess and wield the corporate franchise, that conduct is of a corporate character, and if illegal and injurious may deserve and receive the penalty of dissolution. There always is, and there always must be, corporate conduct without formal corporate action where

the thing challenged is an omission to act at all. A corporation organized in the public interest, with a view to the public welfare, and in the expectation of benefit to the community, which is the motive of the State's grant, may accept the franchise and hold it in sullen silence, doing nothing, resolving nothing, furnishing no formal corporate action upon which the State can put its finger and say, this the corporation has done by the agency through which it is authorized to act. That is corporate conduct which the State may question and punish without searching for a formal corporate act. The directors of a corporation, its authorized and active agency, may see the stockholders perverting its normal purposes by handing it over, bound and helpless, to an irresponsible and foreign authority, and omit all action which they ought to take, offer no resistance, make no protest, but silently acquiesce as directors in the wrong which as stockholders they have themselves helped to commit. That again is corporate conduct, though there be an utter absence of directors' resolutions. Is it asked what they could have done to prevent the organization of the trust; how they were negligent and unfaithful as corporate officers by their omission to act; what good a mere protest or objection would have accomplished; what effective form their resistance could have assumed? The answer is that they could have refused to recognize the illegal trust transfer of the stock; they could have declined to register the new ownership upon their stock-books; they could have said, and acted upon their words, that the original stockholders remained not only the beneficial, but the legal owners of the stock; and, if the board trustees appealed to the law, the resisting directors could challenge the legality of the transfer as moulded by the combination agreement, and might have defeated the trust and shattered it at the outset of its career. So much they could have done as corporate officers; so much it was their duty to have done as representatives of the corporation; and when, beyond that corporate neglect, they recognized the validity of the stock transfers in trust, put the new and unlawful ownership upon their books, and accepted its votes in the choice of new directors who were to throttle the independence of the corporation and chain it to the will of the trust, I think we must shut our eyes in wilful blindness if we fail to see both corporate neglect and corporate action.

It is true, as we are reminded, that the statute confers upon trustees and directors general authority to manage the stock, property, and concerns of manufacturing corporations; and equally true that, as a general rule and as between the companies and those with whom they deal, the corporate action must be manifested through and by the directors; but other statutes indicate with equal plainness that there are corporate acts which the trustees cannot perform, and which affect and bind the corporation only upon the condition that they proceed from the stockholders, or from them and the trustees acting

together. In increasing or diminishing the capital stock, the corporate act is wholly that of the corporators, and in consolidating two or more companies into one, there must be the joint action of both trustees and stockholders. The trust of the refineries, in substance and effect, approached very near to these two corporate acts, so far as the resultant consequences affected the corporators acting. The trust stipulations practically doubled their corporate stock through the agency of the certificates issued, and the combination in its result is largely the equivalent of a substantial consolidation. If these things had been done lawfully, they would have been accomplished by the united action of trustees and corporators, and beyond any question would have been corporate acts. Having been done unlawfully, but by the same united agency aiming at similar results, they must still constitute corporate conduct, unless the bare fact of their illegality takes away their corporate character. To say that, would disarm the State in every case of misuse or abuse of chartered powers.

The abstract idea of a corporation, the legal entity, the impalpable and intangible creation of human thought is itself a fiction, and has been appropriately described as a figure of speech. It serves very well to designate in our minds the collective action and agency of many individuals as permitted by the law; and the substantial inquiry always is what in a given case has been that collective action and agency. As between the corporation and those with whom it deals, the manner of its exercise usually is material, but as between it and the State, the substantial inquiry is only what that collective action and agency has done, what it has, in fact, accomplished, what is seen to be its effective work, what has been its conduct. It ought not to be otherwise. The State gave the franchise, the charter, not to the impalpable, intangible, and almost nebulous fiction of our thought, but to the corporators, the individuals, the acting and living men, to be used by them, to redound to their benefit, to strengthen their hand, and add energy to their capital. If it is taken away, it is taken from them as individuals and corporators, and the legal fiction disappears. The benefit is theirs, the punishment is theirs, and both must attend and depend upon their conduct; and when they all act, collectively, as an aggregate body, without the least exception, and so acting, reach results and accomplish purposes clearly corporate in their character, and affecting the vitality, the independence, the utility, of the corporation itself, we cannot hesitate to conclude that there has been corporate conduct which the State may review, and not be defeated by the assumed innocence of a convenient fiction. As was said in *People ex rel.* v. *K. & M. T. R. Co.*, 23 Wend. 193, "though the proceeding by information be against the corporate body, it is the acts or omissions of the individual corporators that are the subject of the judgment of the court."

It remains to determine whether the conduct of the defendant in

participating in the creation of the trust, and becoming an element of it, was illegal and tended to the public injury, and we may consider the two questions together and without formal separation.

It is quite clear that the effect of the defendant's action was to divest itself of the essential and vital elements of its franchise by placing them in trust; to accept from the State the gift of corporate life only to disregard the conditions upon which it was given; to receive its powers and privileges merely to put them in pawn; and to give away to an irresponsible board its entire independence and self-control. When it had passed into the hands of the trust, only a shell of a corporation was left standing, as a seeming obedience to the law, but with its internal structure destroyed or removed. Its stockholders, retaining their beneficial interest, have separated from it their voting power, and so parted with the control which the charter gave them and the State required them to exercise. It has a board of directors nominally and formally in office, but qualified by shares which they do not own, and owing their official life to the board which can end their power at any moment of disobedience. It can make no dividends whatever may be its net earnings, and must encumber its property at the command of its master, and for purposes wholly foreign to its own corporate interests and duties. At the command of that master it has ceased to refine sugar, and without any doubt for the purpose of so far lessening the market supply as to prevent what is termed "over production." In all these respects it has wasted and perverted the privileges conferred by the charter, abused its powers, and proved unfaithful to its duties. But graver still is the illegal action substituted for the conduct which the State had a right to expect and require. It has helped to create an anomalous trust which is, in substance and effect, a partnership of twenty separate corporations. The State permits in many ways an aggregation of capital, but mindful of the possible dangers to the people, over-balancing the benefits, keeps upon it a restraining hand, and maintains over it a prudent supervision, where such aggregation depends upon its permission and grows out of its corporate grants. It is a violation of law for corporations to enter into a partnership. *N.Y. & S.C. Co.* v. *F. Bank*, 7 Wend. 412; *Clearwater* v. *Meredith*, 1 Wall. 29; *Whittenton Mills* v. *Upton*, 10 Gray, 596. The case last cited furnishes the reasons with precision and at length. It shows the utter inconsistency of a double allegiance by those who act for the corporation to two different principals, and demonstrates that the vital characteristics of the corporation are of necessity drowned in the paramount authority of the partnership. That the combination of the refineries partakes of the nature of a partnership is not denied. Indeed, in one of the papers added to the appellant's brief, it is not only admitted but asserted and defended. That paper shows quite clearly, that by force of the arrangement, there was a community of

interest in the fund created by the corporate earnings before division, and that each member of the trust shared in the profit and loss of all. It is said, however, that a consolidation of manufacturing corporations is permitted by the law, and that the trust or combination or partnership, however it may be described, amounts only to a practical consolidation which public policy does not forbid because the statute permits it. Laws of 1867, chap. 960; Laws of 1884, chap. 367. The refineries did not avail themselves of that statute. They chose to disregard it, and to reach its practical results without subjection to the prudential restraints with which the State accompanied its permission. If there had been a consolidation under the statute, one single corporation would have taken the place of the others dissolved. They would have disappeared utterly, and not, as under the trust, remained in apparent existence to threaten and menace other organizations and occupy the ground which otherwise would be left free. Under the statute the resultant combination would itself be a corporation deriving its existence from the State, owing duties and obligations to the State, and subject to the control and supervision of the State, and not, as here, an unincorporated board, a colossal and gigantic partnership, having no corporate functions and owing no corporate allegiance. Under the statute the consolidated company taking the place of the separate corporations could have as capital stock only an amount equal to the fair aggregate value of the rights and franchises of the companies absorbed; and not as here a capital stock double that value at the outset and capable of an elastic and irresponsible increase. The difference is very great and serves further to indicate the inherent illegality of the trust combination.

And here I think we gain a definite view of the injurious tendencies developed by its organization and operation, and of the public interests which are menaced by its action. As corporate grants are always assumed to have been made for the public benefit, any conduct which destroys their normal functions, and maims and cripples their separate activity, and takes away their free and independent action, must so far disappoint the purpose of their creation as to affect unfavorably the public interest; and that to a much greater extent when beyond their own several aggregations of capital they compact them all into one combination which stands outside of the ward of the State, which dominates the range of an entire industry, and puts upon the market a capital stock proudly defiant of actual values, and capable of an unlimited expansion. It is not a sufficient answer to say that similar results may be lawfully accomplished; that an individual having the necessary wealth might have bought all these refineries, manned them with his own chosen agents, and managed them as a group at his sovereign will; for it is one thing for the State to respect the rights of ownership and protect them out of

regard to the business freedom of the citizen, and quite another thing to add to that possibility a further extension of those consequences by creating artificial persons to aid in producing such aggregations. The individuals are few who hold in possession such enormous wealth, and fewer still who peril it all in a manufacturing enterprise; but if corporations can combine, and mass their forces in a solid trust or partnership, with little added risk to the capital already embarked, without limit to the magnitude of the aggregation, a tempting and easy road is opened to enormous combinations, vastly exceeding in number and in strength and in their power over industry any possibilities of individual ownership; and the State by the creation of the artificial persons constituting the elements of the combination, and failing to limit and restrain their powers, becomes itself the responsible creator, the voluntary cause of an aggregation of capital which it simply endures in the individual as the product of his free agency. What it may bear is one thing, what it should cause and create is quite another.

And so we have reached our conclusion, and it appears to us to have been established, that the defendant corporation has violated its charter and failed in the performance of its corporate duties, and that in respects so material and important as to justify a judgment of dissolution. Having reached that result, it becomes needless to advance into the wider discussion over monopolies and competition and restraint of trade and the problems of political economy. Our duty is to leave them until some proper emergency compels their consideration. Without either approval or disapproval of the views expressed upon that branch of the case by the courts below, we are enabled to decide that in this State there can be no partnerships of separate and independent corporations, whether directly, or indirectly through the medium of a trust; no substantial consolidations which avoid and disregard the statutory permissions and restraints, but that manufacturing corporations must be and remain several as they were created, or one under the statute.

The judgment appealed from should be affirmed with costs.

All concur.

Judgment affirmed.

NOTE. — See, *accord*, *State* v. *Standard Oil Co.*, 49 Ohio St. 137.

LINN TIMBER CO. *v.* UNITED STATES.

236 U.S. 574. 1915.

MR. JUSTICE HOLMES delivered the opinion of the court.

These are suits in equity brought by the United States against the appellants to annul patents issued under the Timber and Stone Act

of June 3, 1878, c. 151, 20 Stat. 89, on the ground that the entries were fraudulent. Both of the courts below have found that the entries were fraudulent, that the defendant Smith was either a party to the fraud or chargeable with notice of it, and that the Linn & Lane Timber Company stood in no better position than Smith. The Circuit Court of Appeals made decrees for the United States in respect of all the lands concerned. 181 Fed. Rep. 545. 196 Fed. Rep. 593; 116 C.C.A. 267. 203 Fed. Rep. 394; 121 C.C.A. 498. The main question here concerns the statute of limitations: "suits to vacate and annul patents hereafter issued shall only be brought within six years after the date of the issuance of such patents." Act of March 3, 1891, c. 561, § 8; 26 Stat. 1095, 1099. See Act of March 3, 1891, c. 559; 26 Stat. 1093. In No. 46 the twenty-eight patents in controversy were issued on August 12, 1902. In No. 159, nine of the patents were issued on August 12, 1902, and eight on July 9, 1902. The bills were filed and subpœnas were taken out and delivered to the Marshal on May 25, 1908. On July 20 the Marshal returned *non est inventus* as to Smith. An order of notice was applied for on the same day, suggesting that he was residing in Minneapolis, and was granted on July 27. Smith was served with process on August 11, 1908, and the corporation was made a party on November 16, and was served on November 18, 1908; so that it will be seen that the corporation was not brought into the suit until more than six years had run after the issue of all the patents and that Smith was served more than six years after the issue of eight of the patents involved in No. 159. On the other hand the bills were filed within six years.

The patented lands had been conveyed to various persons in trust for Smith in 1900, shortly after the making of final proof. In May, 1906, Smith, still having the equitable or legal title, organized a Minnesota corporation, the appellant, with 1000 shares of $100 each, for the purpose of receiving and holding the title to these and other lands. He took 998 shares, his wife one, and his attorney one. He then offered to pay for the stock with the land, and subsequently caused to be executed deeds purporting to convey the lands to the corporation, but he retained the deeds and did not have them recorded until September 9, 1908, after the beginning of these suits, and more than six years after the issue of the patents. It is found, it would seem reasonably, that one purpose of Smith was to keep the titles concealed until the statute of limitations should have run. The United States was ignorant of the transaction. But a month from the recording of the conveyances to the corporation Smith and other defendants pleaded it in abatement, and in November, as we have said, the United States filed amended bills.

Upon the facts as found by the two courts below we must take it that the corporation was the mere tool of Smith, that his knowledge was its knowledge, *McCaskill Co.* v. *United States*, 216 U.S. 504, and

that it was party to an effort to keep the title concealed until it was too late for the United States to complain. It even is open to some doubt whether the deeds ever were delivered until they were recorded, and it seems open to none that, as was said by the Circuit Court of Appeals, recording the deeds was the first business the corporation did. This being so, the difference in legal personality between Smith and the corporation gives the corporation no greater rights than Smith. It cannot be privy to a fraud and on the ground of its success set up a title of which, if that be material, Smith is to have substantially the whole advantage, and thus defeat the adjudication against Smith that otherwise would undo the fraud. There is no question of creditors' rights and the only ground for hesitation is that before the bill was filed some of the shares had been pledged by Smith, and fifteen shares had been transferred to one Johnson and also pledged for Smith's debt. But we are of opinion with the findings that the position was not changed as between the United States, Smith and the corporation in such a way as to give the last a better standing in this case. Those who took the stock as security did not deal with the corporation as outsiders, but became a part of it while it still was under the manifest domination of Smith and charged with participation in Smith's fraud. The corporation cannot derive any new right from them. *Wilson Coal Co.* v. *United States*, 110 C.C.A. 343; 188 Fed. Rep. 545. Whether they have a remedy is not a question here.

We now are not considering the effect of a fraudulent concealment of a cause of action. We are considering whether a man who knows that his title is bad and will be attacked can call into being a corporation which he owns, in order to save the property, make a deed to it, put the deed into his pocket, leave it unrecorded and, without the need of trusting even an accomplice, can keep it with perfect security until the statute has run, and then set up that his creature owns the land. We are deciding that if a secret transfer of wrongfully held land is made in this way for the purpose of busying the United States with the wrong person until the title shall be made good by time, service on the man thus put forward is sufficient to avoid the statute and the trick must fail.

The bills were filed and subpœnas were taken out and delivered to the Marshal for service before the statute had run, reasonable diligence was shown in getting service and therefore the rights of the United States against all the patents were saved. For when so followed up the rule is pretty well established that the statute is interrupted by the filing of the bill. *Coppin* v. *Gray*, 1 Y. & C., C.C. 205, 207. *Purcell* v. *Blennerhassett*, 3 Jo. & Lat. 24, 45. *Foster* v. *Thompson*, 4 Dr. & Warr. 303, 318. *Hele* v. *Lord Bexley*, 20 Beav. 127. *Hayden* v. *Bucklin*, 9 Paige (N.Y.), 512. *Aston* v. *Galloway*, 38 No. Car. 126. *Dilworth* v. *Mayfield*, 36 Mississippi, 40, 52. *United*

States v. *American Lumber Co.*, 85 Fed. Rep. 827, 830. *United States* v. *Miller*, 164 Fed. Rep. 444.

There was an attempt made in argument to reopen the questions of fact upon which the two courts below agreed, but we see no reason to depart from the common rule and therefore we do not advert to any of those matters. It also was argued that the decision of the Secretary of the Interior that the patents should be issued is conclusive. But the decision was obtained by such frauds that the matter was open for reconsideration by the courts. *Washington Securities Co.* v. *United States*, 234 U.S. 76.

Decrees affirmed.

NOTE. — See also *Rickey Land & Cattle Co.* v. *Miller*, 218 U.S. 258.

As to the criminal liability of a person who controls a corporation, for the misapplication of money entrusted in form to the corporation see *Milbrath* v. *State*, 138 Wis. 354; *King* v. *Grubb*, [1915] 2 K.B. 683.

MOORE & HANDLEY CO. *v.* TOWERS HARDWARE CO.

87 Ala. 206. 1888.

THE bill in this case was filed on the 3d December, 1888, by the Towers Hardware Company, a private corporation, against the Moore & Handley Hardware Company, another private corporation; and sought an injunction to restrain the defendant from selling "plow-stocks and plow-blades," in violation of a contract made between the complainant and a partnership doing business under the name of Moore, Moore & Handley, which was composed of James D. Moore, Benj. F. Moore, and William A. Handley, who, as the bill alleged, afterwards formed the defendant corporation. The complainant was incorporated, under the general statutes, on the 1st February, 1887, and the defendant on the 12th March, 1888; each having its principal place of business in Birmingham, and selling hardware throughout the northern counties of the State mostly on orders effected through their travelling salesmen. The partnership of Moore, Moore & Handley had been engaged in the same business, and on the 27th May, 1887, they sold out their entire stock of plow-stocks and plow-blades, at the price of $728 paid in cash, to the complainant; signing an agreement, which was written at the foot of the memorandum, or bill of sale, in these words: "In consideration of above sale, we agree not to handle any more plow-stocks or plow-blades, except railroad plows." The bill alleged that the price paid was about $100 more than the market value of the articles, and that complainant was induced to make said purchase "solely by said

written promise and undertaking of said Moore, Moore & Handley." By the terms of defendant's articles of incorporation, its capital stock was $100,000, of which said partners each subscribed $25,000, and one Thos. P. Wimberly $25,000; but the bill alleged that, "if said Wimberly ever really had any interest in said corporation, or the capital stock thereof, by virtue of having paid anything on his subscription, he no longer has any interest therein, nor has had since before (to-wit) August 8th, 1888;" also, on information and belief, that said Moores and Handley "are the sole owners of the capital stock of said corporation, and have been since August 10th, 1888," J. D. Moore being president, Handley vice-president, and B. F. Moore secretary, ever since its organization; that the defendant corporation was organized for the purpose of carrying on the same business which the partnership had carried on; that its capital stock "was paid for wholly and entirely in the stock of goods and assets of said partnership;" that it "succeeded to all the property rights and assets of said partnership, as well as all the liabilities thereof;" that said defendant corporation "is none other than said J. D. Moore, B. F. Moore and Wm. A. Handley, who constituted said partnership, and now constitute said corporation. Your orator can not say whether or not said Moores and Handley organized said corporation for the purpose of evading the force and effect of their said agreement with your orator, but does say and charge that the effect of their doing so would be to perpetrate a fraud on your orator, if they should be allowed to handle plow-blades and plow-stocks; that the defendant's business, as now conducted, is identically the same as that conducted by said Moores and Handley, is conducted by the same persons, and in substantially the same manner as before, and that the only change in fact has been in the name of the concern. And your orator alleges that said Moores and Handley, in making said agreement with your orator, thereby meant and intended, and such was your orator's intention, that they would not again engage in selling or handling plow-blades or plow-stocks in connection with their said business in the city of Birmingham, so long as your orator was engaged in the like business."

The defendant answered the bill, admitting its allegations as to the contract between the complainant and Moore, Moore & Handley, and the nature of the business carried on by the several parties; denying that it assumed, or in any manner became liable for, the obligations of said partnership, or of its individual partners, or that it acquired any interest in the outstanding notes and accounts due to said partnership, or the real estate owned by the partners, which was more than sufficient to pay all their outstanding debts and liabilities; alleging that Wimberly owned a one-fourth interest in the corporation at its organization, and for some time acted as its treasurer, but admitting that the Moores and Handley had since bought

out his interest; insisting that said contract was illegal and void, because in restraint of trade, and, if valid, was not binding on the defendant; and demurring to the bill for want of equity.

After answer filed, the defendant submitted a motion to dissolve the temporary injunction, and to dismiss the bill; and this appeal is taken from the decree of the chancellor overruling and refusing these motions.

McCLELLAN, J. The equity of the bill, so far as the injunction is concerned, and the sufficiency of those of its allegations which are not denied by the answer to sustain the injunction, depend primarily on two questions: *first*, whether the contract relied on is void, as being in unreasonable restraint of trade; and, *second*, whether a negative undertaking entered into by persons who subsequently organize, and for the time constitute, a corporation for the prosecution of the business with respect to which the contract was made, can be enforced by injunction against the corporation.

[The contract was held to be valid.]

The general doctrine is well established, and obtains both at law and in equity, that a corporation is a distinct entity, to be considered separate and apart from the individuals who compose it, and is not to be affected by the personal rights, obligations and transactions of its stockholders; and this, whether said rights accrued, or obligations were incurred, before or subsequent to incorporation. Morawetz on Priv. Corp. 227–234, 547–549; *Morrison* v. *Gold Mt. G. M. Co.*, 52 Cal. 309; *Hawkins* v. *Mansfield G. M. Co.*, *Ib.* 515; *Gent* v. *M. & Mut. Ins. Co.* 107 Ill. 658; *Caledonian R. Co.* v. *Helensburgh*, 2 Macq. 391; *Penn. Mat. Co.* v. *Hapgood*, 141 Mass. 147.

There is a class of contracts, however, which are entered into between the promoters or prospectors of a contemplated corporation and third persons, on the faith of the corporation, intended to enure to its benefit, and which in point of fact do enure to its benefit, on which the corporation will be charged, even in the absence of an express promise to perform, or ratification on the part of the company after it is *in esse;* on "the familiar principle, that one who accepts the benefit of a contract, which another volunteers to perform in his name, and on his behalf, is bound to take the burden with the benefit." Redfield on Railways (5th ed.), 18; *Edwards* v. *Grand Junc. R.*, 1 M. & Cr. 650; *Stanley* v. *Birkenhead R.*, 9 Sim. 264; *L. R. & Fet. S. R. Co.* v. *Perry*, 37 Ark. 164; *Perry* v. *L. R. & Fet. S. R. Co.*, 44 Ark. 383; *Bommer* v. *Am. Spiral Co.*, 81 N.Y. 468.

And in those cases where "associates combine together to create a paper corporation, to cover a partnership or joint venture, and where the stockholders are partners in intention," and have resorted to the fiction of separate corporate entity to free themselves from individual obligations which had attached to them, with respect to the business they propose to carry on, prior to the organization of

the company, courts of equity, when the ends of justice require it, will disregard and look beyond the fiction of corporate entity, and hold the corporation to a discharge of the liabilities resting on its members; and this may be done, although some of the shareholders had not originally incurred the obligation sought to be enforced, provided they had notice of it before entering the corporation, and participated in the effort to avoid it. *Davis Imp. Wrought Iron W. W. Co.* v. *Davis Wrought Iron W. Co.*, 20 Fed. Rep. 700; *Beal* v. *Chase*, 31 Mich. 490, 495, 532.

The contract of Moore, Moore & Handley, sought to be enforced against the Moore & Handley Hardware Company, was not an undertaking between promoters of the company and third parties, nor made on the faith of the corporation, nor intended to enure to its benefit, nor did it enure, in point of fact, to the benefit of the corporation. It is not of that class of contracts which courts enforce against corporations, on the ground that they were made in the corporate name by anticipation, and that the corporation received and accepted the benefits resulting from them.

There is no allegation of fraud made against the corporation, or its shareholders, and the implication of the fraudulent effect of the corporate action complained of is denied. It is not shown that this is a mere "paper corporation," to cover a joint venture, in which the corporators are partners in intention, and have resorted to this form for the purpose of evading and avoiding obligations which they had taken upon themselves as individuals, or for the purpose of evading the promise relied on here. If these things had appeared in the case, we should not hesitate to hold the corporation answerable for the individual obligation. But, in the absence of fraud, "no authorities have gone the length of holding that any contract made with individuals, exclusively upon individual credit, will become the contract of any future corporation that may be formed for the more convenient management and use of the benefits of it." *L. R. & Ft. S. R. Co. Cases, supra.*

If the case of *Beal* v. *Chase, supra*, goes beyond this doctrine, we can not indorse it. We do not think it does. In that case, the corporation had been formed *for the purpose* of violating a contract not to engage in a certain business. All the corporators were held to have participated in this purpose. The business was to be conducted by the corporation, in connection with the promisor in his individual capacity. He had an interest in it, both individually and as the principal shareholder of the company; and the court enjoined the corporation, not generally, but from carrying on the business with or for the individual contracting party. To put the case at bar in line with that case, it would have to appear, not only that the corporators organized for the purpose, and with the intention of evading their contract, through the separate entity of corporate existence, but also

that they reserved an interest in the business distinct from their interests as stockholders. None of these facts are shown. The effect of allowing the injunction in this case to continue, would necessarily be to hold all future shareholders in the corporation to the performance of a contract which neither they nor the corporation had ever entered into, and of which they may not even have had notice. Such a result could only be justified on the ground of bad faith in the creation of the company. To thus hamper a *bona fide* corporation, would be inequitable, and have the effect of establishing a doctrine fraught with much danger to corporate rights, powers and property.

The allegations going to show a ratification, by the corporation, of this contract of Moore, Moore & Handley, are denied by the answer, and hence can not be considered in passing on the decree overruling the motion to dissolve the injunction. Those allegations of the bill which are not denied, were not sufficient to authorize a continuance of the injunction, and the decree on that point was erroneous, and is reversed.

The contract relied on here is such a one as the respondent corporation could have made under its charter. It is, therefore, one which, being already in existence between complainant and the individuals composing the defendant company, the corporation had the power to ratify and adopt. The bill, in our judgment, sufficiently avers such ratification or adoption. These allegations give equity to the bill, and the decree overruling the demurrer is affirmed.

The cause will be remanded, with instructions to the chancellor to dissolve the injunction, unless the complainant amends its bill so as to entitle it to a continuance of the writ, under the principles we have announced.

Reversed and remanded.

NOTE. — *Beal* v. *Chase*, 31 Mich. 490. Chase contracted not to engage in a certain business. He thereafter, with other persons who knew of his contract, formed a corporation of which he was a large shareholder and the president, which engaged in the business. It was formed for that purpose. The corporation was enjoined "from doing said business with or for Chase, directly or indirectly." See also *Gormully Co.* v. *Bretz*, 64 Fed. 612.

Hagy v. *McGuire*, 147 Pa. 187. Defendants contracted not to sell certain products except to the plaintiffs. They formed a corporation which dealt in such products and sold them to persons other than the plaintiffs. This was held to be a breach of the defendants' contract.

Kramer v. *Old*, 119 N.C. 1. A, B, and C covenanted not to engage in a business. They subsequently organized a corporation, to engage in the business, and became the principal stockholders and the managing officers of such corporation. There were other stockholders who knew of the covenant by A, B, and C before they put

any money into the corporation. The court enjoined A, B, and C from taking stock or assisting in the organization of a corporation formed with the purpose of carrying on such business, but it refused to enjoin X from engaging in such business. See also *Iowa Wire Co.* v. *Southern Wire Co.*, 30 Fed. 123.

HALL'S SAFE CO. *v.* HERRING-HALL-MARVIN SAFE CO.

146 Fed. 37. 1906.

SEVERENS, Circuit Judge. From about the year 1847 to 1867, one Joseph L. Hall had, in successive co-partnerships with other persons, been engaged at Cincinnati, Ohio, in the manufacture and sale of fire and burglar proof safes. In this business he had been the principal and managing member of his firms. In the latter year (1867) he with other persons organized a corporation under the laws of Ohio by the name of "Hall's Safe & Lock Company," for the purpose of carrying on the same business. Its factory and principal office were located at Cincinnati, and its business of selling safes extended throughout the United States and into foreign countries. Its safes were known as "Hall's Safes" and "Hall's Standard Safes," and certain styles of them were marked "Hall's Standard Safes," and the safes had a good reputation. In March, 1889, the said Joseph L. Hall, who was at that time the principal stockholder in the corporation last mentioned, died. His sons, Edward C., William H., and Charles O. Hall, were also stockholders. The first two became, successively, presidents of the corporation. The stock of Joseph L. Hall continued part of his estate, and the business went on as before until May 4, 1892, when the corporation sold to the Herring-Hall-Marvin Company, a New Jersey corporation, all its "real estate and leasehold interests, tools, machinery, fixtures, merchandise, trade-marks and good will," and the Hall's Safe & Lock Company covenanted and agreed that it would close up its affairs and be dissolved and would not in the future engage or continue in said business. This sale and agreement was assented to by the above-named sons of Joseph L. Hall, who are the individuals made defendants in this cause. Edward C. Hall and William H. Hall at or about the date of the transfer became stockholders (as we must suppose), directors, and, respectively, president and treasurer, of the Herring-Hall-Marvin Company, at stated salaries agreed upon at the time of said transfer. But in 1895 these persons were deposed from their offices, and their salaries reduced, and on August 1, 1896, they resigned their offices as directors. Their resignations were accepted, and they withdrew from the company. At the time when these parties became associated

with the Herring-Hall-Marvin Company, a written agreement with that company was entered into by each of them, which, after stating the terms of their employment, contained the following stipulation: —

"And in consideration as aforesaid, I, the said Edward C. Hall (in the other contract, William H. Hall), do hereby covenant, promise, and agree that I will not, so long as the Herring-Hall-Marvin Company may desire to retain my services as above, engage, either in the state of Ohio, or in the state of New Jersey, or in any of the states east of the Mississippi river, in the business of manufacturing, selling, buying, or dealing in fire or burglar proof vaults and safes, or in any business or occupation such as the said corporation known as the Hall's Safe & Lock Company has heretofore been engaged in, or such as the Herring-Hall-Marvin Company is authorized or impowered to engage in, or in any other business which will or may compete or interfere in any manner with the business of the said Herring-Hall-Marvin Company."

In September, 1896, Edward C. Hall, William H. Hall, Charles O. Hall, and other persons organized a corporation under the laws of Ohio by the name of the "Hall's Safe Company," the corporate defendant herein, and this company shortly thereafter went into the business of manufacturing and selling safes.

[Counsel for complainant contended that the contract of Hall's Safe & Lock Company bound the individuals Edward C., William H., and Charles O. Hall.]

Upon this contention it becomes important to determine what were and are the relations between the complainant and its predecessor in title and the several defendants. Undoubtedly the Herring-Hall-Marvin Company acquired by its contract of purchase with the Hall Safe & Lock Company all its physical properties and the good will which it had acquired in its business, as well as the right to use such trade-names as had been customarily used to identify its products. It acquired also the right to require that the Hall's Safe & Lock Company should go out of business, or, in substance, that it should not longer engage in business of the kind which it sold to the Herring-Hall-Marvin Company. But it is contended that the contract reaches beyond the corporation, the Hall Safe & Lock Company, and binds the defendants who were stockholders and officers of the corporation, and prevents them and any corporation of which they may become stockholders and managers from doing what the Hall Safe & Lock Company could not do; and the principal reason for this contention is the fact that these individual defendants participated in the sale, and as stockholders received its benefits. We are of opinion that this proposition cannot be sustained. The contract which the Herring-Hall-Marvin Company had was with the corporation only, and not with its stockholders or officers. The officers who con-

ducted the business of the selling company were not parties to the contract. It is a familiar rule that an agent, who, having lawful authority, makes a contract with another for a known principal, does not bind himself, but his principal only (Story on Agency, § 261; Mechem on Agency, § 555; *Whitney* v. *Wyman*, 101 U.S. 392, 25 L. Ed. 1050); and the officers of a private corporation, in respect to their liability on contracts entered into by them in behalf of the corporation, stand upon the same footing as agents of private individuals (21 Am. & Eng. Ency. of Law [2d Ed.] 879; *Whitney* v. *Wyman*, *supra*). If the purchaser desired to make the officers and agents of the selling corporation subject to the stipulations of the company in the contract of sale, it should have required their personal agreement to that effect.

The cases cited by counsel for the complainant to support their contention that the court may look through the form of a corporate organization, and fasten upon the stockholders a liability for the acts of the corporation, do not support such a doctrine as applicable to contract relations. These are *State* v. *Standard Oil Co.*, 49 Ohio St. 137, 30 N.E. 279, 15 L.R.A. 145, 34 Am. St. Rep. 541; *McKinley* v. *Wheeler*, 130 U.S. 630, 9 Sup. Ct. 638, 32 L. Ed. 1048; and *Anthony* v. *American Glucose Co.*, 146 N.Y. 407, 41 N.E. 23. They were all cases where, for special purposes and in special circumstances, the court held that it was competent and proper to regard the rights and duties of stockholders in corporations. None of them impugns the general rule above stated that in matters of contract the officers and agents of a corporation are not bound personally by stipulations made by them in behalf of their principal. This rule is not affected by the circumstance that they are indirectly interested as stockholders in the contracts of their corporation. If it were so, it would break down all distinction between the corporate entity and its component parts.

NOTE. — In *Donnell* v. *Herring-Hall-Marvin Safe Co.*, 208 U.S. 267, Mr. Justice HOLMES said (p. 273): "But it was said that if a partnership had sold out by a conveyance in like terms the members would have given up the right to use their own names if they appeared in the firm name, that in this case the Halls received the consideration for the good will they had attached to their name, that they ratified the sale and necessarily assented to it, since otherwise the corporation could not have sold its property or have carried out its agreement to dissolve, and that under such circumstances a court ought to look through the corporation to the men behind it.

"Philosophy may have gained by the attempts in recent years to look through the fiction to the fact and to generalize corporations, partnerships and other groups into a single conception. But to generalize is to omit, and in this instance to omit one characteristic of the complete corporation, as called into being under modern statutes,

that is most important in business and law. A leading purpose of such statutes and of those who act under them is to interpose a non-conductor, through which in matters of contract it is impossible to see the men behind. However it might be with a partnership, *Russia Cement Co.* v. *Le Page*, 147 Massachusetts, 206, 211, when this corporation sold its rights everybody had notice and knew in fact that it was not selling the rights personal to its members, even if, as always, they really received the consideration, or, as usual, they all assented to its act. That it contracted for such assent, if it did, by its undertaking to dissolve, does not make the contract theirs. But the case does not stop there. The purchasing company had the possibility of competition from the Halls before its mind and gave the measure of its expectations and demands by the personal contracts that it required. Those contracts were limited in time and scope and have been discharged."

BRODERIP *v.* SALOMON.

[1895.] 2 Ch. 323.

SALOMON *v.* SALOMON & CO., LTD.

[1897.] A.C. 22.

In 1892 Aron Salomon was carrying on business as a leather merchant, etc., and was solvent. On July 28, 1892, a limited company was registered under the Companies Act of 1862. The memorandum of association was subscribed by Aron Salomon and his wife and daughter and four sons, each subscribing for one share.

The Companies Act provided (§ 6) that "any seven or more persons, associated for a lawful purpose may, by subscribing their names to a memorandum of association, and otherwise complying with the provisions of the act in respect of registration, form a company with or without limited liability." "No subscriber shall take less than one share" (§ 8). The act prescribed no minimum value for shares, and hence the shares might be of as small a value as those who formed the company pleased. Nor did the Act impose any limit upon the number of shares which a single member might subscribe for. § 30 provided that no notice of any trust should be entered on the register. Upon the registration of the memorandum of association, and of the articles (where required), the registrar was required to certify that the company was incorporated. "The subscribers of the memorandum of association, together with such other persons as may from time to time become members of the company, shall thereupon be a body corporate by the name contained in the memorandum of association, capable forthwith of exercising all the functions of an in-

corporated company, and having perpetual succession and a common seal, with power to hold lands." . . . (§ 18.)

Salomon conveyed his business to this company, and the company issued to him debentures and shares. The net result was that the company had the business, and Salomon had certain debentures, and 20,001 shares out of a total of the 20,007 issued. The total number of shares authorized was 40,000, but the remaining 19,993 were not issued, nor offered to the public. Nor were any of the 20,007 shares offered to the public.

The company became insolvent. The assets which remained after paying one Broderip, whose right to be paid in priority to the unsecured creditors was not questioned, were not sufficient to pay the debentures held by Salomon. If these remaining assets were applied on the debentures held by Salomon, the unsecured creditors of the company would receive nothing. The unsecured creditors, other than Salomon himself, had claims for 7733*l.* 8*s.* 3*d.*

The matter came before VAUGHAN WILLIAMS, J., and the following is an abridgment of his opinion: —

There was no fraud on the shareholders, inasmuch as they were all perfectly cognizant of the conditions under which the company was formed, and as there was no intention to allot further shares at a later period to outsiders. But the company was a mere nominee of Salomon's; and the case is to be dealt with as if the nominee, instead of being the company, had been some individual agent of Salomon's to whom he had purported to sell this business. In that case the trustee in bankruptcy of the agent would have had a right to make Salomon indemnify the agent against the debts that he had contracted by the direction of his principal. The right of the liquidator in the present case is precisely the same, notwithstanding the debentures which were a mere form, intended to give an appearance of reality to a sale which, in fact, was no sale at all, because it was a sale by a man to an agent for his own profit. This business was Salomon's business, and no one else's. The creditors of the company could, in my opinion, have sued Salomon. Their right to do so would depend on the circumstances of the case, whether the company was a mere *alias* of the founder or not. The relationship of principal and agent existed between Salomon and the company. The moment the creditors succeed in establishing the identity of Salomon with the company, the creditors of the company thereupon are shown to be the creditors of Salomon; and although it is necessary, in order to get rid of the priority given to Salomon by these debentures, that one should fall back upon the lien of the company as his agent, whom he was bound to indemnify, I do not mean to exclude from my judgment that the debentures were given to Salomon by his agent, the company, and that the necessary effect of Salomon as principal, taking these debentures from his agent, the

company, was that his creditors — for, according to my view, the creditors of the company were his creditors — were defeated and delayed by the debentures.

His Lordship made the following order: —

Declare that the plaintiffs, A. Salomon & Co. Limited, or the liquidator thereof are, or is entitled to be indemnified by the defendant A. Salomon against the sum of 7733*l.* 8*s.* 3*d.* . . .

Order and adjudge that the plaintiffs, A. Salomon & Co. Limited, do recover against defendant A. Salomon the said sum of 7733*l.* 8*s.* 3*d.*

Declare that plaintiffs, A. Salomon & Co. Limited, are entitled to a lien for the said sum of 7733*l.* 8*s.* 3*d.*, upon all sums which would be payable to defendant A. Salomon out of the assets of the plaintiffs A. Salomon & Co. Limited.

LINDLEY, L.J. This is an appeal by Mr. Aron Salomon against an order made by VAUGHAN WILLIAMS, J., and which, in effect, directs Mr. A. Salomon to indemnify a limited company formed by him against the unsecured debts and liabilities incurred by or in the name of the company whilst it carried on business.

The appeal raises a question of very great importance, not only to the persons immediately affected by the decision, but also to a large number of persons who form what are called "one-man companies." Such companies were unheard of until a comparatively recent period, but have become very common of late years.

There can be no doubt that in this case an attempt has been made to use the machinery of the Companies Act, 1862, for a purpose for which it never was intended. The legislature contemplated the encouragement of trade by enabling a comparatively small number of persons — namely, not less than seven — to carry on business with a limited joint stock or capital, and without the risk of liability beyond the loss of such joint stock or capital. But the legislature never contemplated an extension of limited liability to sole traders or to a fewer number than seven. In truth, the legislature clearly intended to prevent anything of the kind, for § 48 takes away the privilege conferred by the Act from those members of limited companies who allow such companies to carry on business with less than seven members; and by § 79 the reduction of the number of members below seven is a ground for winding up the company. Although in the present case there were, and are, seven members, yet it is manifest that six of them are members simply in order to enable the seventh himself to carry on business with limited liability. The object of the whole arrangement is to do the very thing which the legislature intended not to be done; and, ingenious as the scheme is, it cannot have the effect desired so long as the law remains unaltered. This was evidently the view taken by VAUGHAN WILLIAMS, J.

The incorporation of the company cannot be disputed. (See § 18

of the Companies Act, 1862.) Whether by any proceeding in the nature of a scire facias the Court could set aside the certificate of incorporation is a question which has never been considered, and on which I express no opinion; but, be that as it may, in such an action as this the validity of the certificate cannot be impeached. The company must, therefore, be regarded as a corporation, but as a corporation created for an illegitimate purpose. Moreover, there having always been seven members, although six of them hold only one 1*l.* share each, Mr. Aron Salomon cannot be reached under § 48, to which I have already alluded. As the company must be recognized as a corporation, I feel a difficulty in saying that the company did not carry on business as a principal, and that the debts and liabilities contracted in its name are not enforceable against it in its corporate capacity. But it does not follow that the order made by VAUGHAN WILLIAMS, J., is wrong. A person may carry on business as a principal and incur debts and liabilities as such, and yet be entitled to be indemnified against those debts and liabilities by the person for whose benefit he carries on the business. The company in this case has been regarded by VAUGHAN WILLIAMS, J., as the agent of Aron Salomon. I should rather liken the company to a trustee for him — a trustee improperly brought into existence by him to enable him to do what the statute prohibits. It is manifest that the other members of the company have practically no interest in it, and their names have merely been used by Mr. Aron Salomon to enable him to form a company, and to use its name in order to screen himself from liability. This view of the case is quite consistent with *In re George Newman & Co.*, [1895] 1 Ch. 674. In a strict legal sense the business may have to be regarded as the business of the company; but if any jury were asked, Whose business was it? they would say Aron Salomon's, and they would be right, if they meant that the beneficial interest in the business was his. I do not go so far as to say that the creditors of the company could sue him. In my opinion, they can only reach him through the company. Moreover, Mr. Aron Salomon's liability to indemnify the company in this case is, in my view, the legal consequence of the formation of the company in order to attain a result not permitted by law. The liability does not arise simply from the fact that he holds nearly all the shares in the company. A man may do that and yet be under no such liability as Mr. Aron Salomon has come under. His liability rests on the purpose for which he formed the company, on the way he formed it, and on the use which he made of it. There are many small companies which will be quite unaffected by this decision. But there may possibly be some which, like this, are mere devices to enable a man to carry on trade with limited liability, to incur debts in the name of a registered company, and to sweep off the company's assets by means of debentures which he has caused to be issued to himself in order to defeat the

claims of those who have been incautious enough to trade with the company without perceiving the trap which he has laid for them.

It is idle to say that persons dealing with companies are protected by § 43 of the Companies Act, 1862, which requires mortgages of limited companies to be registered, and entitles creditors to inspect the register. It is only when a creditor begins to fear he may not be paid that he thinks of looking at the register; and until a person is a creditor he has no right of inspection. As a matter of fact, persons do not ask to see mortgage registers before they deal with limited companies; and this is perfectly well known to every one acquainted with the actual working of the Companies Acts and the habits of business men. Mr. Aron Salomon and his advisers, who were evidently very shrewd people, were fully alive to this circumstance.

If the legislature thinks it right to extend the principle of limited liability to sole traders it will no doubt do so, with such safeguards, if any, as it may think necessary. But until the law is changed such attempts as these ought to be defeated whenever they are brought to light. They do infinite mischief; they bring into disrepute one of the most useful statutes of modern times, by perverting its legitimate use, and by making it an instrument for cheating honest creditors.

Mr. Aron Salomon's scheme is a device to defraud creditors.

Agreeing as I do in substance with VAUGHAN WILLIAMS, J., I do not think it necessary to investigate the question whether the so-called sale of the business to the company ought to be set aside. The only object of setting it aside is to obtain assets wherewith to pay the creditors, and this object can be attained on sound legal principles by the order which he has made. In the event, however, of this case going further, I will add that I regard the so-called sale of the business to the company as a mere sham, and that in my opinion it might, if necessary, be set aside by the company in the interest of its creditors, although all the shareholders, such as they were, knew of and assented to the arrangement. They were simply assisting Mr. Aron Salomon to carry out his scheme. I cannot regard *In re British Seamless Paper Box Co.*, 17 Ch.D. 467, as an authority against a rescission of such a transaction as this.

We have carefully considered the proper form of order to be made on this appeal, and the order of the Court will be as follows: The Court, being of opinion that the formation of the company, the agreement of August, 1892, and the issue of debentures to Aron Salomon pursuant to such agreement, were a mere scheme to enable him to carry on business in the name of the company with limited liability, contrary to the true intent and meaning of the Companies Act, 1862, and, further, to enable him to obtain a preference over other creditors of the company by procuring a first charge on the assets of the company by means of such debentures, dismiss the appeal of Aron Salomon with costs; and, it being unnecessary to

make any order on the liquidators' cross-notice of appeal, discharge the order directing the liquidator to pay costs of the counter-claim, and give him those costs.

LOPES, L.J. This is a case of very great importance, and I wish shortly to state my reasons for concurring in the judgment just delivered. I do not propose to restate the facts so fully and clearly detailed by LINDLEY, L.J.: I shall content myself with shortly stating the impression they have produced on my mind. The incorporation of the company was perfect — the machinery by which it was formed was in every respect perfect, every detail had been observed; but, notwithstanding, the business was, in truth and in fact, the business of Aron Salomon; he had the beneficial interest in it; the company was a mere *nominis umbra*, under cover of which he carried on his business as before, securing himself against loss by a limited liability of 1*l.* per share, all of which shares he practically possessed, and obtaining a priority over the unsecured creditors of the company by the debentures of which he had constituted himself the holder.

It would be lamentable if a scheme like this could not be defeated. If we were to permit it to succeed, we should be authorizing a perversion of the Joint Stock Companies Acts. We should be giving vitality to that which is a myth and a fiction. The transaction is a device to apply the machinery of the Joint Stock Companies Act to a state of things never contemplated by that Act — an ingenious device to obtain the protection of that Act in a way and for objects not authorized by that Act, and in my judgment in a way inconsistent with and opposed to its policy and provisions. It never was intended that the company to be constituted should consist of one substantial person and six mere dummies, the nominees of that person, without any real interest in the company. The Act contemplated the incorporation of seven independent bonâ fide members, who had a mind and a will of their own, and were not the mere puppets of an individual who, adopting the machinery of the Act, carried on his old business in the same way as before, when he was a sole trader. To legalize such a transaction would be a scandal.

But to what relief is the liquidator entitled? In the circumstances of this case it is, in my opinion, competent for the Court to set aside the sale as being a sale from Aron Salomon to himself — a sale which had none of the incidents of a sale, was a fiction, and therefore invalid; or to declare the company to be a trustee for Aron Salomon, whom Aron Salomon, the cestui que trust, was bound to indemnify; or to declare the formation of the company, the agreement of August, 1892, and the issue of the debentures to Aron Salomon pursuant to such agreement, to be merely devices to enable him to carry on business in the name of the company with limited liability, contrary to the true intent and meaning of the Companies Act, 1862, and

further, to enable him to obtain a preference over other creditors of the company by obtaining a first charge on the assets of the company by means of such debentures. I wish to add that I am inclined to think that a scire facias would go to repeal the certificate of incorporation; but I express no decided opinion on the point. The appeal will be dismissed with costs.

[KAY, L.J., delivered a concurring opinion.]

From the above decision, Salomon appealed to the House of Lords. His appeal was brought *in forma pauperis.*

. . . .

Lord HERSCHELL. [After stating the facts, and reciting the previous proceedings.]

It is to be observed that both courts treated the company as a legal entity distinct from Salomon and the then members who composed it, and therefore as a validly constituted corporation. This is, indeed, necessarily involved in the judgment which declared that the company was entitled to certain rights as against Salomon. Under these circumstances, I am at loss to understand what is meant by saying that A. Salomon and Company Limited is but an *alias* for A. Salomon. It is not another name for the same person; the company is *ex hypothesi* a distinct legal *persona.* As little am I able to adopt the view that the company was the agent of Salomon to carry on his business for him. In a popular sense a company may in every case be said to carry on business for and on behalf of its shareholders, but this certainly does not in point of law constitute the relation of principal and agent between them or render the shareholders liable to indemnify the company against the debts which it incurs. Here, it is true, Salomon owned all the shares except six, so that if the business were profitable he would be entitled substantially to the whole of the profits. The other shareholders, too, are said to have been "dummies," the nominees of Salomon. But when once it is conceded that they were individual members of the company distinct from Salomon, and sufficiently so to bring into existence in conjunction with him a validly constituted corporation, I am unable to see how the facts to which I have just referred can affect the legal position of the company, or give it rights as against its members which it would not otherwise possess.

The Court of Appeal based their judgment on the proposition that the formation of the company, and all that followed it, was a mere scheme to enable the appellant to carry on business in the name of the company, with limited liability, contrary to the true intent and meaning of the Companies Act 1862. The conclusion which they drew from this premiss was, that the company was a trustee and Salomon their *cestui que trust.* I cannot think that the conclusion follows even if the premiss be sound. It seems to me that the logical result would be that the company had not been validly constituted,

and therefore had no legal existence. But, apart from this, it is necessary to examine the proposition on which the court have rested their judgment, as its effect would be far reaching. Many industrial and banking concerns of the highest standing and credit have, in recent years, been, to use a common expression, converted into joint-stock companies, and often into what are called "private" companies, where the whole of the shares are held by the former partners. It appears to me that all these might be pronounced "schemes to enable" them "to carry on business in the name of the company, with limited liability," in the very sense in which those words are used in the judgment of the Court of Appeal. The profits of the concern carried on by the company will go to the persons whose business it was before the transfer, and in the same proportions as before, the only difference being that the liability of those who take the profits will no longer be unlimited. The very object of the creation of the company, and the transfer to it of the business, is that, whereas the liability of the partners for debts incurred was without limit, the liability of the members for the debts incurred by the company shall be limited. In no other respect is it intended that there shall be any difference; the conduct of the business and the division of the profits are intended to be the same as before. If the judgment of the Court of Appeal be pushed to its logical conclusion all these companies must, I think, be held to be trustees for the partners who transferred the business to them, and those partners must be declared liable, without limit, to discharge the debts of the company. For this is the effect of the judgment as regards the respondent company. The position of the members of a company is just the same whether they are declared liable to pay the debts incurred by the company, or by way of indemnity to furnish the company with the means of paying them. I do not think that the learned judges in the court below have contemplated the application of their judgment to such cases as I have been considering, but I can see no solid distinction between those cases and the present one.

It is said that the respondent company is a "one-man" company, and that in this respect it differs from such companies as those to which I have referred. But it has often happened that a business transferred to a joint-stock company has been the property of three or four persons only, and that the other subscribers of the memorandum have been clerks or other persons who possessed little or no interest in the concern. I am unable to see how it can be lawful for three or four or six persons to form a company for the purpose of employing their capital in trading, with the benefit of limited liability, and not for one person to do so, provided in each case the requirements of the statute have been complied with, and the company has been validly constituted. How does it concern the creditor whether the capital of the company is owned by seven persons in

equal shares, with the right to an equal share of the profits, or whether it is almost entirely owned by one person who practically takes the whole of the profits? The creditor has notice that he is dealing with a company the liability of the members of which is limited, and the register of shareholders informs him how the shares are held, and that they are substantially in the hands of one person, if this be the fact. The creditors in the present case gave credit to and contracted with a limited company; the effect of the decision is to give them the benefit as regards one of the shareholders, of unlimited liability. I have said that the liability of persons carrying on business can only be limited provided the requirements of the statute be complied with, and this leads naturally to the inquiry what are those requirements?

The Court of Appeal has declared that the formation of the respondent company and the agreement to take over the business of the appellant, were a scheme "contrary to the true intent and meaning of the Companies Act." I know of no means of ascertaining what is the intent and meaning of the Companies Act except by examining its provisions and finding what regulations it has imposed as a condition of trading with limited liability. The memorandum must state the amount of the capital of the company and the number of shares into which it is divided, and no subscriber is to take less than one share. The shares may, however, be of as small a nominal value as those who form the company please; the statute prescribes no minimum, and though there must be seven shareholders, it is enough if each of them holds one share, however small its denomination. The Legislature therefore clearly sanctions a scheme by which all the shares, except six, are owned by a single individual, and these six are of a value little more than nominal.

It was said that in the present case the six shareholders other than the appellant were mere dummies, his nominees, and held their shares in trust for him. I will assume that this was so. In my opinion it makes no difference. The statute forbids the entry in the register of any trust, and it certainly contains no enactment that each of the seven persons subscribing the memorandum must be beneficially entitled to the share or shares for which he subscribes. The persons who subscribe the memorandum or who have agreed to become members of the company, and whose names are on the register, are alone regarded as, and, in fact, are, the shareholders. They are subject to all the liability which attaches to the holding of the share. They can be compelled to make any payment which the ownership of a share involves. Whether they are beneficial owners or bare trustees is a matter with which neither the company nor creditors have anything to do; it concerns only them and their *cestui que trust* if they have any. If, then, in the present case all the requirements of the statute were complied with, and a company was effectually constituted, and

this is the hypothesis of the judgment appealed from, what warrant is there for saying that what was done was contrary to the true intent and meaning of the Companies Act?

It may be that a company constituted like that under consideration was not in the contemplation of the Legislature at the time when the Act authorizing limited liability was passed; that if what is possible under the enactments as they stand had been foreseen, a minimum sum would have been fixed as the least denomination of share permissible, and it would have been made a condition that each of the seven persons should have a substantial interest in the company. But we have to interpret the law, not to make it; and it must be remembered that no one need trust a limited liability company unless he so please, and that before he does so he can ascertain, if he so please, what is the capital of the company, and how it is held.

In the original appeal, order appealed from reversed.
In the cross appeal, order appealed from affirmed.

NOTE. — *Booth* v. *Helliwell,* [1914] 3 K.B. 252. Booth formed a company of which he was practically the only shareholder. The company carried on a business, in the course of which a sale of butter was made by an assistant in the shop which was a violation of the Sale of Food and Drugs Act, 1875. Held, that the assistant was the servant of the company, and not of Booth.

Cf. Cuppens Wooden Ware Co. v. *Illinois Mfg. Co.*, 51 La. Ann. 64.

CONTINENTAL TYRE & RUBBER CO. LTD. *v.* DAIMLER CO., LTD.

[1915.] 1 K.B. 893.

LORD READING, J.C. These two actions are brought for the purpose of determining whether during the war payment of a debt can be enforced by a company of which all the shareholders and directors are alien enemies. In the first action SCRUTTON, J., affirmed the order of the Master giving leave to sign final judgment under Order XIV. In the second, the action was tried before LUSH, J., who decided in favour of the plaintiff company. The present appeals are against both judgments and by consent were heard together. They have been ably and elaborately argued and raise points of considerable importance.

The plaintiffs are a limited liability company incorporated under the Companies Acts. They carry on business in London at the registered office of the company and have a number of agencies throughout the United Kingdom. The company was formed in 1905 with a

capital of 10,000*l.*, increased in 1908 to 25,000*l.*, to trade in motor car tyres made in Germany by a company incorporated under German law. The German company formed a number of subsidiary companies in various parts of the world for the sale of these tyres. The plaintiff company was formed for the purpose of selling such tyres in the United Kingdom. At the date of the writ the German company held 23,398 shares in the plaintiff company, and the remaining shares (except one) are now held by subjects of the German Empire residing in Germany. The one share is registered in the name of the secretary of the company, who was born in Germany, resided in London, and in January, 1910, became a naturalized subject of the Crown. The directors are subjects of the German Empire and are resident in Germany. The business is managed according to the evidence of the secretary by two managers and himself, all three being resident in this country.

In the first case the plaintiff company is the drawer and holder of bills accepted by the defendants for goods supplied before the declaration of war. The bills matured for payment and were presented after the declaration of war. In the second case the plaintiffs' claim is for a balance of account for goods supplied before the war. It is admitted by both defendants (except as to a small amount in the second action) that the goods have been delivered and that payment for them is due, but both defendants have resisted payment on the ground that in the circumstances above stated the plaintiff company was not entitled to receive and could not enforce payment of the debt. The appellants contend that the plaintiff company must be regarded as an alien enemy notwithstanding that it is a limited liability company, and that as commercial intercourse between persons under the protection of the Crown and persons who are alien enemies is illegal, payment to the plaintiff company must be illegal. They further contend that the Court should look at the substance and not the technicalities of the matter. If the plaintiff company is to be regarded as an alien enemy the payment would be illegal under the common law and also under paragraph 5, sub-paragraph 1, of the Royal Proclamation relating to Trading with the Enemy issued on September 9, 1914, which forbids payment to or for the benefit of an alien enemy, and is a Proclamation in force within s. 1, sub-s. 2, of the Trading with the Enemy Act, 1914. The appellants further contend that the directors, having become alien enemies at the outbreak of the war, ceased to be directors of the company, and that as no other directors had been appointed no authority had been or could be given to bring these actions. These contentions require careful consideration.

It cannot be disputed that the plaintiff company is an entity created by statute. It is a company incorporated under the Companies Acts and therefore is a thing brought into existence by virtue

of statutory enactment. At the outbreak of war it was carrying on business in the United Kingdom; it had contracted to supply goods, it delivered them, and until the outbreak of the war it was admittedly entitled to receive payment at the due dates. Has the character of the company changed because on the outbreak of war all the shareholders and directors resided in an enemy country and therefore became alien enemies? Admittedly it was an English company before the war. An English company cannot by reason of these facts cease to be an English company. It remains an English company regardless of the residence of its shareholders or directors either before or after the declaration of war. Indeed it was not argued by Mr. Gore-Browne that the company ceased to be an entity created under English law, but it was argued that the law in time of war and in reference to trading with the enemy should sweep aside this "technicality" as the entity was described and should treat the company not as an English company but as a German company and therefore as an alien enemy. If the creation and existence of the company could be treated as a mere technicality, there would be considerable force in this argument. It is undoubtedly the policy of the law as administered in our courts of justice to regard substance and to disregard form. Justice should not be hindered by mere technicality, but substance must not be treated as form or swept aside as technicality because that course might appear convenient in a particular case. The fallacy of the appellants' contention lies in the suggestion that the entity created by statute is or can be treated during the war as a mere form or technicality by reason of the enemy character of its shareholders and directors. A company formed and registered under the Companies Acts has a real existence with rights and liabilities as a separate legal entity. It is a different person altogether from the subscribers to the memorandum or the shareholders on the register (per Lord MACNAGHTEN in *Salomon* v. *Salomon & Co.*, [1897] A.C. 22, at p. 51. It cannot be technically an English company and substantially a German company except by the use of inaccurate and misleading language. Once it is validly constituted as an English company it is an artificial creation of the Legislature and it retains its existence for all intents and purposes. It is a living thing with a separate existence which cannot be swept aside as a technicality. It is not a mere name or mask or cloak or device to conceal the identity of persons and it is not suggested that the company was formed for any dishonest or fraudulent purpose. It is a legal body clothed with the form prescribed by the Legislature.

In determining whether a company is an English or foreign corporation no inquiry is made into the share register for the purpose of ascertaining whether the members of the company are English or foreign. Once a corporation has been created in accordance with the requirements of the law it is an English company notwithstanding

that all its shareholders may be foreign. Just as a foreign corporation does not become British and cease to be foreign if all its members are subjects of the British Crown (per Lord MACNAGHTEN, Lord BRAMPTON, and Lord LINDLEY in *Janson* v. *Driefontein Consolidated Mines*, [1902] A.C. 484, at pp. 497, 501, and 505). For the appellants' contention to succeed payment to the company must be treated as payment to the shareholders of the company, but a debt due to a company is not a debt due to all or any of its shareholders: *Salomon* v. *Salomon & Co.*, [1897] A.C. 22. The company and the company alone is the creditor entitled to enforce payment of the debt and empowered to give to the debtor a good and valid discharge. Once this conclusion is reached it follows that payment to the plaintiff company is not payment to the alien enemy shareholders or for their benefit.

The same result is arrived at under paragraph 3 of the above mentioned Proclamation. It defines "enemy" in paragraph 3. "The expression 'enemy' in this Proclamation means any person or body of persons of whatever nationality resident or carrying on business in the enemy country, but does not include persons of enemy nationality who are neither resident nor carrying on business in the enemy country. In the case of incorporated bodies, enemy character attaches only to those incorporated in an enemy country."

Therefore although payment is forbidden "to or for the benefit of an enemy" this prohibition does not apply when payment is made to a company incorporated in this country. Under this Proclamation it appears clear that the test of residence or place of carrying on business to determine whether an incorporated body was enemy or not is not to be applied. The company only becomes enemy if incorporated in the enemy country, and as the plaintiff company was not incorporated in the enemy country, enemy character does not attach to it. Further it is provided by § 1, sub-section 2, of the Trading with the Enemy Act, 1914, that any transaction permitted by or under any Proclamation issued by His Majesty dealing with trading with the enemy shall not be deemed to be trading with the enemy. As by the Proclamation enemy character attaches only to those incorporated in a foreign country it follows that payment to a company incorporated in this country is not only not forbidden, but is in our opinion impliedly permitted. (Both in the Proclamation and the statutes relating to trading with the enemy the adjective "alien" is not used, doubtless because it was thought superfluous when once "enemy" had been defined.)

It must, however, be clearly understood that any person who on behalf of the plaintiff company paid money to shareholders resident or carrying on business in Germany or to a company incorporated in Germany would be acting in defiance of the law, and none the less because payment is made in the name of the company. That would be

a criminal offence and would be within the express prohibition of paragraph 5, sub-paragraph 1, as defined by paragraph 3. The plaintiff company has never claimed any such right and has explicitly disclaimed any such intention. According to the evidence money received is paid into the plaintiffs' banking account and 9000*l.* per month is drawn out and paid into another account of the plaintiff company at the bank for the purpose of meeting expenses and establishment charges throughout the United Kingdom; the remainder of the money received is left to accumulate in the bank.

It is to be observed that if payment to a company would be payment "to or for the benefit of an enemy" because all the shareholders are enemies and because payment to the company must be regarded as payment to the shareholders it would seem to follow that payment of a debt to a company which had some enemy shareholders would equally come within the forbidden area. The appellants' answer is that their contention extends at most to those companies in which enemy shareholders are in the majority and in such circumstances as would lead to the conclusion of fact that substantially the company is enemy. Further if this contention were rejected it is urged that when as in the present case all the shareholders and directors are enemies there is no room for doubt as to the fact and a decision in the appellants' favour could be confined to the special facts. There does not appear to be any logical ground for these distinctions. If it were permissible to look behind the existence of the entity and to regard the character of the individual shareholders in order to determine whether or not the payment is "to or for the benefit of an enemy" the suggested line of demarcation would be wholly arbitrary. If payment to a company with a majority of enemy shareholders is to be regarded as payment to an enemy company, what is the position of the other shareholders? Can it be suggested that the minority consisting of British or neutral shareholders cease to be shareholders in an English company and become members of an enemy corporation?

There is no judicial authority for the proposition of the appellants and indeed there is a weight of judicial opinion against it. See *Salomon* v. *Salomon & Co.*, [1897] A.C. 22, and *Janson* v. *Driefontein Consolidated Mines*, [1902] A.C. 484. *Gramophone and Typewriter* v. *Stanley*, [1908] 2 K.B. 89, is a recent instance of the refusal of the court to treat the entity of a company as a mere form or technicality. The Commissioners of Inland Revenue sought to make the Gramophone Company, which was an English company, liable to pay income tax in respect of profits made by a German company in which the English company held all the shares. None of such profits had been received by the English company in this country, but it was sought to treat the profits of the German company for the purpose of income tax as if they were the profits of the English company. The

Court of Appeal was of opinion that the business of the German company had not become the business of the English company. Notwithstanding that the English company held all the shares in the German company, the English company could not be treated as having any right to the undistributed profits of the German company. A fortiori it could not have any right to the payment of a debt due to the German company. See also *Kodak* v. *Clark*, [1902] 2 K.B. 450; [1903] 1 K.B. 505.

The argument of the appellants that, although the plaintiff company was an English company in times of peace, it could not be so regarded in time of war was further supported by Mr. Leslie Scott on the ground that the plaintiff company could not be regarded as a subject of the Crown. He said the company could not be a subject, it had no mind, it could not be loyal or disloyal to the State. He urged that alone the character of the shareholders must determine whose subject the plaintiff company is, and that when all the shareholders are enemy the plaintiff company is enemy. This point was discussed in *Janson* v. *Driefontein Consolidated Mines*, [1902] A.C. 484. The litigation arose out of the South African war. The respondent corporation was formed and registered in the Transvaal Republic; most of the shareholders were resident outside the Republic, and were not subjects of it. The appellant, an underwriter and a British subject, objected that the corporation was alien enemy and could not sue. It was argued for the respondents that the corporation should not be regarded as subject to the laws of the Transvaal and as alien enemy. None of their Lordships favoured that view. Some of their Lordships assumed for the purpose of the case, but did not decide, that the company remained an alien enemy notwithstanding that most of the shareholders were not alien enemies (see Lord HALSBURY, p. 490, Lord MACNAGHTEN, p. 497, and possibly Lord DAVEY only assumed it, p. 498). Lord LINDLEY (p. 505) was of opinion that the company must be regarded as resident and carrying on business in the Transvaal and subject to the laws of that country, and he added: "When war broke out the company became an alien enemy of this country: see the American case of *Society for the Propagation of the Gospel* v. *Wheeler*, 2 Gallison (U.S.) 105. If it becomes material to attribute nationality to the company it would, in my opinion, be correct to say that the company was a Transvaal company and a subject of the Transvaal Government, although almost all its shareholders were foreigners resident elsewhere and subjects of other countries." Lord BRAMPTON, at p. 501, said: "The company clearly must be treated as a subject of the Republic, notwithstanding the nationality of its shareholders." These opinions are not to be taken as part of the actual decision, nevertheless they are opinions of great weight. In *Daniel* v. *The Award of the Commissioners for Liquidating British Claims on France*, 2 Knapp, P.C.

23, and in *Long* v. *the Same*, 2 Knapp, P.C. 51, it was held by the Privy Council that a corporation of British subjects existing in a foreign country and under control of a foreign Government must be considered as a foreign corporation, and was, therefore, not entitled to claim compensation under a treaty giving this right to British subjects. The corporation was the subject of the foreign State, and not of the British Crown. Even in reference to the ownership of a ship it was held in *The Queen on the Prosecution of the Pacific Steam Navigation Company* v. *Arnaud and Powell*, (1846) 16 L.J. (Q.B.) 50, that, notwithstanding that some of the members of the corporation were not British subjects but foreigners, the British corporation was the sole owner of the ship and a British subject. None of these authorities lend support to the appellants' argument; they tend rather to assist the plaintiff's case.

There remains, however, the case decided in 1809, *Bank of the United States* v. *Deveaux*, 5 Cranch, 61, upon which much reliance was placed by Mr. Leslie Scott. The Supreme Court of the United States there decided that the Court could look beyond the corporate name and notice the character of the individuals who composed the corporation and treat them substantially as parties to the controversy. The question at issue arose from a peculiarity of the Constitution of the United States. The State Courts alone have jurisdiction to try all civil actions except in certain cases reserved by the Constitution and the Judiciary Law to the Federal Courts. One of these reserved cases is where a citizen of one State sues a citizen of another. A suit having been brought in the Federal Court in the corporate name of the bank, it was held by the Supreme Court that a corporation aggregate cannot in its corporate capacity be a citizen, and, therefore, had no right of access to the Federal Court, though it was incorporated in and by one State and was suing the citizen of another State. However, MARSHALL, C.J., who delivered the opinion of the Court, held that, although the corporation could not be a citizen, the Court could look behind the corporate name to ascertain the individuals composing it, so as to determine whether they were citizens of one State suing the citizens of another. The learned Chief Justice based his judgment upon *City of London* v. *Wood*, (1701) 12 Mod. 669, which he treated as an authority for his decision that the Court could look behind the corporate name. Upon an examination of that case, and notwithstanding the high authority of the learned Chief Justice, it does not support so sweeping a proposition. It was a case of a very special character. An action was brought by the Mayor and Commonalty of the City of London in the Court of the Mayor and Aldermen of London. Objection was taken that the Mayor, who was the head of the City, without whom the City had no ability or capacity to sue, was also the very person before whom the action was brought for trial. The Court of King's Bench natur-

ally shrank from upholding a judgment given under such circumstances, and held that the objection was fatal, upon the principle that a judge must not be an interested party in the suit before him. A person cannot be both party and judge in the same suit. The familiar instance is that of a judge who is a shareholder in a railway company sued for damages. It is the judge's duty to declare his interest to the parties, and unless they agree to waive any objection he cannot try the case. The absence of such declaration and assent of the parties is the explanation of this case. It is to be observed that in the decisions of our Courts this case has not been relied upon, and certainly has not been followed, as an authority for any such proposition as was argued before us.

Since the argument an examination of American authorities has disclosed that the case of *Bank of the United States* v. *Deveaux*, 5 Cranch, 61, has not since its decision found favour in the Supreme Court of the United States. In 1844, in the case of *Louisville Railroad Co.* v. *Letson*, (1844) 2 Howard 497, at p. 555, the Supreme Court thought that that case had gone too far and held that "a corporation created by a State to perform its functions under the authority of that State and only suable there, though it may have members out of the State, seems to us to be a person, though an artificial one, inhabiting and belonging to that State, and therefore entitled, for the purpose of suing and being sued, to be deemed a citizen of that State. We remark too that the cases of Strawbridge and Curtis and the Bank and Deveaux have never been satisfactory to the Bar, and that they were not, especially the last, entirely satisfactory to the Court that made them. They have been followed always most reluctantly and with dissatisfaction. By no one was the correctness of them more questioned than by the late Chief Justice who gave them. It is within the knowledge of several of us that he repeatedly expressed regret that those decisions had been made, adding, whenever the subject was mentioned, that if the point of jurisdiction was an original one, the conclusion would be different. We think we may safely assert that a majority of the members of this Court have at all times partaken of the same regret, and that whenever a case has occurred on the circuit involving the application of the case of the Bank and Deveaux it was yielded to, because the decision had been made, and not because it was thought to be right." In 1895, in the case of *St. Louis and San Francisco Railway* v. *James*, (1896) 161 U.S. 545, the Supreme Court again approved the view that the Bank and Deveaux had gone too far, and held that there was an indisputable legal presumption that a corporation is composed of citizens of the State which created it and that presumption of citizenship is one of law not to be defeated by evidence to the contrary. Although not binding upon us, the decision of MARSHALL, C.J., and of the Supreme Court is entitled to our very high respect, and

this has caused us to give our most careful consideration to this judgment. It is satisfactory to find in the result that the law of the United States is that the corporation is regarded as a citizen of the State in which it is created, and is, therefore, not in conflict but in harmony with our law.

It was further contended on behalf of the appellants that such technicalities have not been allowed to bind the decisions of the Prize Court, and the case of *The Tommi*, [1914] P. 251, was cited. The President there said: "The decision as to when property passes is often very difficult when dealing with municipal law. It depends upon fine technicalities; but the like technicalities have not been allowed to bind the decisions of the Prize Courts when transfers of property are attempted when war is actual or imminent. They have been treated as gossamer, which can be wiped entirely aside, because the Prize Court regards the essential qualities of a transaction, and tries to arrive at the realities of the case. . . ." It is sufficient for the purpose of this case to say that in this Court we are administering the municipal law and must follow it. In the later case of *The Roumanian*, [1915] P. 26, decided on December 7, 1914, a point more closely resembling that in these appeals came before the President. It was a claim to resist condemnation of the cargo ex the vessel on the ground that the owner of the cargo, the Europäische Petroleum Union, though a company incorporated at Bremen under the laws of the Empire of Germany, was in substance and reality a company owned and controlled by companies or firms in allied or neutral countries. In fact only 10 per cent. of the shareholders of the company were alien enemies, the other 90 per cent. being allies or neutrals. The learned President in giving judgment says: "Neutral bodies and subjects are shareholders to a considerable extent in this company. It is a corporate body duly incorporated under the laws of Germany and as such entered an appearance in these proceedings. There was some discussion in argument as to its constitution, but it was not really denied that it was a German company. It clearly is." The owner of the cargo of oil being therefore an enemy company, the decree for condemnation was made and the German company's claim failed. The decision in *The Roumanian*, [1915] P. 26, shows that the character of the entity and not of the shareholders was regarded. That is in accordance with the municipal law and is unfavourable to the appellants' argument before us.

Lastly we were invited to decide against the plaintiff company on the ground that to allow it to recover debts during the war would be against public policy. A somewhat similar argument was addressed to the House of Lords in *Janson* v. *Driefontein Consolidated Mines*, [1902] A.C. 484, but it found no favour with any of their Lordships. If the law on this subject had hitherto been in doubt, which it was not, it was firmly and finally settled in that case. Noth-

ing would more easily tend to create uncertainty and confusion in our law than to allow considerations of public policy as distinguished from law based upon public policy to be a ground of judicial decision: see *Janson* v. *Driefontein Consolidated Mines*, [1902] A.C. at p. 496. The law is admirably laid down by PARKE, B., in *Egerton* v. *Lord Brownlow and Others*, (1853) 4 H.L.C. 1, at p. 123, and quoted by Lord HALSBURY in *Janson's Case*, [1902] A.C. at p. 496. "It is the province of the statesman, and not the lawyer, to discuss, and of the Legislature to determine, what is the best for the public good, and to provide for it by proper enactments. It is the province of the judge to expound the law only; the written from the statutes: the unwritten or common law from the decisions of our predecessors and of our existing Courts, from text-writers of acknowledged authority, and upon the principles to be clearly deduced from them by sound reason and just inference; not to speculate upon what is the best, in his opinion, for the advantage of the community. Some of these decisions may have no doubt been founded upon the prevailing and just opinions of the public good; for instance, the illegality of covenants in restraint of marriage or trade. They have become a part of the recognised law, and we are therefore bound by them, but we are not thereby authorised to establish as law everything which we may think for the public good, and prohibit everything which we think otherwise."

These weighty and well chosen words uttered by a master of the common law and approved in 1902 by the House of Lords are a conclusive answer to the argument addressed to us on public policy.

[The court then considered the question whether there was authority in the solicitor to issue a writ or to continue the action in behalf of the plaintiff company; and held that there was such authority.]

In our opinion both appeals must be dismissed with costs. This is the judgment of all the members of the Court except BUCKLEY, L.J. The late KENNEDY, L.J., had read the judgment I have just delivered and approved it before his death.

BUCKLEY, L.J. I regret that I am unable to concur in the judgment just delivered. I regard the question as so momentous that I make no apology for stating as clearly as I am able my reasons for arriving at a contrary conclusion.

The artificial legal entity created by incorporation under the Companies Acts is a legal person existing apart from its corporators. This proposition is true without exception, and nothing in this judgment questions the proposition in any way. If there be twelve corporators one of them is not a twelfth or any other part of the corporation. The total number of twelve do not in the aggregate constitute the corporation. On the other hand the corporation cannot exist without corporators. If there are no corporators there can be no corporation. Corporators are essential to the existence of but form no part of the corporation.

The artificial legal person called the corporation has no physical existence. It exists only in contemplation of law. It has neither body, parts, nor passions. It cannot wear weapons nor serve in the wars. It can be neither loyal nor disloyal. It cannot compass treason. It can be neither friend nor enemy. Apart from its corporators it can have neither thoughts, wishes, nor intentions, for it has no mind other than the minds of the corporators. These considerations seem to me essential to bear in mind in determining the present case.

The corporation if it be a British corporation stands in the same position for most purposes as a British subject. For instance as regards rights of ownership of property and the right to protection and assistance by the law. But while it stands for most purposes in the position of a British subject it cannot, I think, be correctly described as a British subject. A subject must, I conceive, be one who can owe and pay allegiance to the King, who can serve the King physically, for instance if he be a male by wearing weapons and serving in the wars, who has a mind and can be either loyal or disloyal to the King. None of these can be predicated of the abstract legal entity. It has no existence at all except in contemplation of law. If these propositions be true, as I think they are, they seem to me to go to the root of the question which has in this case to be determined.

This corporation is one which as a corporation certainly has in law an independent legal existence and that legal person is British. But on the other hand all its directors are Germans resident in Germany. The holders of all its 25,000 shares except one share are Germans resident in Germany. The artificial legal thing is British, resident in England. But all its corporators who can have thoughts, wishes, or intentions are Germans resident in Germany.

The question for determination is whether when all the natural persons who express and give effect to their wishes through the corporation as a legal abstraction are Germans resident in Germany the corporation can sue in this country because those persons who could not sue are as matter of law absorbed in a separate legal person which is British and which (regarding the corporation as a legal person existing apart from and irrespective of its corporators) can sue.

The contractual relations constituted by membership in a corporation under the Companies Acts are singular. The relation between each corporator and the corporation is a contractual relation governed by the statute, involving rights within the corporation, rights against the corporation, and liabilities towards the corporation. Where the corporator is an alien enemy these relations may be vitally affected by a state of war. The motive power of the corporation (which in itself apart from its corporators, or its agents — appointed and authorized through acts done by the corporators — has no life and no power of action) may become paralysed and suspended

by the existence of war in a case where every corporator is as an alien enemy under disability as such.

Suppose the case of a corporation sole. A private company may be formed consisting of only two persons. It was much debated a few years ago whether the law should not be so altered as to allow a sole person to incorporate himself as a company with limited liability. Suppose that were the law, and an individual German resident in Germany, an alien enemy in fact, became incorporated here as a British company, could it be seriously contended that in time of war that alien enemy because he had acquired a legal corporate name and had an artificial legal existence in this country was consequently for the present purpose not an alien enemy? Does it make any difference that there must be two persons, or again does it make a difference that the number is seven or ten? The number of corporators in the present company is six.

The immense importance of the question whether it is impossible for any purpose to look behind the corporation at the person of the corporator may be illustrated by the case of merchant shipping. Under § 1 (*d*) of the Merchant Shipping Act, 1894, ships owned by a shipping company incorporated in this country are British ships. The individual members of that body corporate may be aliens. If the personality of the corporators can for no purpose be regarded there is nothing to prevent alien enemies from owning and sailing British ships under the British flag. If this judgment be (as having regard to the judgment of the other members of the Court I must assume that it is) wrong, the matter is one which calls urgently for legislation.

The proposition that an alien enemy cannot sue rests, I conceive, upon the proposition that such an one cannot approach the King, has no resort to the King, and cannot invoke the assistance of the King. The Court is the King's Court. The alien enemy cannot come into that Court or have the assistance of that Court because the Court is for judicial purposes the King sitting in his Court and the alien enemy cannot approach him. Take the assumed case of the sole person incorporated as I have supposed; can that sole person be entitled to access to the King and assistance from the King because in contemplation of law he is entitled to clothe and has clothed himself in a British dress and notionally but not in fact is British? Take the case of two Germans who had formed a private company; can they approach the King? Take the present case of six Germans; can they approach the King? To say that they can because it is not they but the British corporation which approaches the King seems to me to be unsound. The proposition that it is the British corporation and not the corporators which as matter of legal intendment comes into Court is true, but for the relevant purpose it is not true. The artificial legal entity has no independent power of motion. It is moved by the corporators. It is the German corporator who, under

the corporate name but still German for the relevant purpose of friendliness or enmity, is the person who comes. He is German in fact although British in form.

The question is not wholly without authority which may be a guide. In *City of London* v. *Wood*, 12 Mod. 669, the City of London brought a suit against Wood by their corporate name in the Mayor's Court. Objection was taken that the Court had no jurisdiction by reason of the fact that the Court was held before the Mayor and Aldermen and the action brought in the names of the Mayor and Commonalty and that it is against all law that the same person should be party and judge in the same cause. The objection rested therefore upon the character of the individuals who were members of the Corporation. The judges were unanimous in holding that they could look beyond the corporate name and notice the character of the individual. In *Bank of the United States* v. *Deveaux*, 5 Cranch, 61, the principle of that case was followed in the United States in the case of a suit brought by a corporation aggregate composed of citizens of one State against the citizens of another State in the Circuit Court of the United States. The jurisdiction of that Court was limited to controversies between citizens of different States. The Court affirmed (see p. 86) that the artificial legal entity, the corporation aggregate, was not a citizen and could not sue unless the rights of the members in this respect could be exercised in their corporate name, and that the Court had consequently no jurisdiction unless it could regard the rights of the members in the corporation, for they were citizens. The view the Court took was (see p. 91) that the controversy was substantially between aliens suing by a corporate name and a citizen; or between citizens of one State suing by a corporate name and those of another State. "That name," said MARSHALL, C.J., at p. 87 (meaning the corporation by the corporate name), "cannot be an alien or a citizen; but the persons whom it represents may be the one or the other; and the controversy is, in fact and in law, between those persons suing in their corporate character, by their corporate name, for a corporate right, and the individual against whom the suit may be instituted." The Court accordingly upheld the jurisdiction. Referring to this case, STORY, J., in giving judgment in *Society for the Propagation of the Gospel* v. *Wheeler*, 2 Gallison, 105, at p. 133, said: "But in the character of its members, as *aliens*, we have incontestable authority to enforce the corporate rights; and it has been solemnly settled by the Supreme Court, that for this purpose the Court will go behind the corporate name, and see who are the parties really interested. And if, for this purpose, the Court will ascertain who the corporators are, it seems to follow, that the character of the corporators may be averred, not only to sustain, but also to bar, an action brought in the name of the corporation. It might therefore have been pleaded in this case, even if the cor-

poration had been established in a neutral country, that all its members were alien enemies; and upon such a plea, with proper averments, it would have deserved great consideration, whether it was not, *pendente bello*, an effectual bar." In my opinion the principles laid down in those cases are correct, and none the less because they have, as the Lord Chief Justice has pointed out, been subsequently observed upon in the United States.

In *Janson* v. *Driefontein Consolidated Mines*, [1902] A.C. 484, I do not find any decision to the contrary. The decision there was against the underwriter. The objection that the company was an alien enemy was in his favour. The House made the assumption in his favour and nevertheless decided against him. It was therefore unnecessary to decide the point, and what was said by the noble and learned Lords was only dictum. Lord HALSBURY (p. 490), Lord MACNAGHTEN (p. 497), and Lord DAVEY (as I read his judgment) at p. 498 in fact assumed it, as distinguished from deciding it. Lord BRAMPTON (p. 501) may be read as deciding it, and Lord LINDLEY (p. 505) perhaps even more plainly so. But it cannot be said that the House decided it when it did not arise for decision, and some at any rate of its members plainly abstained from deciding it and stated that they assumed it for the purpose of the decision.

An argument has been advanced that some language in the Act of 1914 and the Proclamation made under it bears upon the question — I think not.

I find in § 2, sub-section 2 (*b*), of the Trading with the Enemy Act, 1914, neither licence nor recognition relevant in the matter. The subjects of the enemy State there spoken of may be subjects resident in Great Britain and consequently not alien enemies. They may be British subjects resident or carrying on business in the foreign State and thus alien enemies by residence and not by nationality. There are many cases to which the sub-section may relate without making the assumption that it relates to a company in which all the corporators are subjects of the enemy State residing in the enemy State. To operate as a licence or recognition the words of the statute ought, I apprehend, to be plain. So far from their being plain it seems to me that it is only by a strained construction that the words can be made relevant to the subject-matter at all.

The definition of enemy in the Proclamation of September 9, 1914, has in my opinion no bearing upon the matter. A Proclamation can neither make nor declare the law, and even if it could that definition does not affect so to do. It does no more than attribute a meaning to a particular word in a particular document. The last words of the article upon which the question arises seem to me, moreover, very obscure. Strictly read it would seem that according to the definition enemy character would not attach to a British corporation resident (as it may be) or carrying on business (as it may do) in the

enemy country when it does attach to a natural person so resident or carrying on business. The reason of the difference is far to seek.

For the above reasons I am of opinion that the Continental Tyre Company stand for the present purpose in the position of alien enemies, for that, to use the language of *Bank of the United States* v. *Deveaux,* 5 Cranch, at p. 91, the action is by "aliens suing by a corporate name." I therefore think that these appeals should be allowed. The right form of order I think would be to set aside the service of the writ and to order the plaintiffs to pay the costs of the action.

Appeals dismissed.

NOTE. — *Peoples Pleasure Co.* v. *Rohleder,* 109 Va. 439. A restriction in the conveyance of land to the effect that "the title of this land is never to rest in a person or persons of African descent," or "colored persons" is not violated by a subsequent conveyance of the land to a corporation, organized "to establish and develop a pleasure park for the amusement of colored people," and composed exclusively of colored persons.

Rex v. *London County Council,* [1915] 2 K.B. 466. The London County Council refused to grant to the London and Provincial Electric Theatres, Limited, the renewal of licences for the exhibition of inflammable cinematograph films and for the performance of music at three theatres. The Council, in taking this action, was influenced by the fact that a majority of the shares of the company were held by alien enemies. On an application for the issue of a writ of mandamus to compel the Council to grant such renewals, the Court of Appeal, by READING, C.J., said (p. 475): "The second and more serious contention is that the Council have not exercised their discretion in a judicial spirit in the sense that they have allowed extraneous considerations to affect their decisions. If they have allowed themselves to take into consideration matters which had no bearing upon the merits of the case before them, but which nevertheless influenced their minds in arriving at their decision, they have not exercised their discretion properly and have not heard and determined the case according to law: see *Reg.* v. *Bowman,* [1898] 1 Q.B. at p. 666, per WILLS, J. The discretion vested in the Council must be exercised within regular limits; in particular, regard should be had only to the merits of the matter before the Council. Although the Council does not sit as a court of law, they must exercise their discretion in a judicial spirit: see *Sharp* v. *Wakefield,* [1891] A.C. at p. 179, per Lord HALSBURY. The difficulty lies in the application of these principles to the present case. The Council came to the conclusion that a company whose directorate and shareholding were constituted as the directorate and shareholding of the London and Provincial Electric Theatres, Limited, was not a suitable company to which or to whose representative in their discretion and opinion licences should be

granted. It must be borne in mind that this Court, in determining whether or not the mandamus should issue, is not exercising appellate jurisdiction. We are not entitled to decide according to the view we should have taken in the first instance had the matter come before us. We should only order the mandamus to issue if we came to the conclusion that the Council, by taking into consideration the enemy character of the constitution of the company, had allowed their minds to be influenced by extraneous considerations. The Council in these matters are the guardians of the public interest and welfare. If the Council are of opinion that the exhibition of cinematograph films accompanied by music should not be entrusted to a company so largely composed of persons whose interest or whose desire at the present time is or may be to inflict injury upon this country, can it be held as a matter of law that the Council have travelled beyond the limits allowed to them? I think not. I cannot hold that such considerations are extraneous or extra-judicial. These exhibitions exercise a powerful influence, often too powerful an influence, upon the minds of the young; sometimes also upon the minds of others. I cannot think that a Court of law would be justified in treating such considerations as beyond the limits to which a man could look who was desirous of discharging his duty honestly to the best of his ability and with his mind directed solely to the public interest of the realm at a critical period of its history. At such a time suspicion as to the possible action or influence, direct or indirect, of enemies is naturally very rife, and an honest man might well think it wise to run no risk and to take precautions to guard against even the remote possibility of injury being caused to this country's interests which to others might appear wholly unnecessary and even unwise, perhaps unjust. If the majority of the members of the Council came to the conclusion that it was not suitable that such a company should at such a time be licenced to carry on such exhibitions, it cannot, in my opinion, be said to be an arbitrary exercise of discretion or to be based upon extraneous considerations.

"The case of *Continental Tyre and Rubber Co.* v. *Daimler Co.*, [1915] 1 K.B. 893, recently decided by the full Court of Appeal, has been to some extent relied upon in support of the company's contention. That decision has only a remote bearing, if any, upon the present case. In that case the Court held that a company formed under our laws and carrying on business in this country could recover a debt due to the company notwithstanding that its directors and shareholders were alien enemies, on the ground that the entity alone could be regarded and that in no circumstances could the debt be treated as a debt to the individual shareholders. The Court was pronouncing upon the legal right of the company to sue and enforce its claims for payment of a debt. No question of the exercise of discretion by the Court arose or could arise in such a case."

See also *Robson* v. *Premier Oil Co. Ltd.*, [1915] 2 Ch. 124.

BOOK II.

THE PROMOTION OF CORPORATIONS.

CHAPTER I.

SUBSCRIPTIONS TO STOCK OF A CORPORATION TO BE FORMED.

ATHOL MUSIC HALL COMPANY *v.* CAREY.

116 Mass. 471. 1875.

Contract on the following agreement:

"We, the undersigned, severally promise and agree to and with each other that we will associate ourselves into a corporation, the name whereof shall be determined by the members thereof, and pay to the treasurer of said corporation the amount of the several shares set against our respective names, for the purpose of purchasing the homestead of Washington H. Amsden, in Athol, on Main Street, and erecting a public hall thereon. The amount of the capital stock of said corporation to be not less than twenty thousand dollars.

Names.	No. of shares.	Amount.
John Carey,	One,	$100."

The declaration alleged that the defendant entered into and signed the above contract, (a copy whereof was annexed,) and thereby agreed, in consideration of other parties signing similar agreements, to pay to the treasurer of the Athol Music Hall Company, the sum of $100, for one share in the capital stock of said corporation when it should be organized. It then alleged the organization, the purchase of the homestead of Amsden, the building of a public hall thereon, a demand for the $100, readiness to deliver the stock, and the refusal of the defendant to pay.

At the trial in the Central District Court of Worcester, the defendant asked the judge to rule that the action could not be maintained on the pleadings. This request was refused. It appeared in evidence that the action was commenced August 11, 1873, under the instructions of the treasurer, by George W. Horr. The only authority therefor was the following votes of the board of directors:

"May 15, 1873. Voted that the treasurer be authorized and instructed to obtain the assistance of George W. Horr, Esq., in making collections of unpaid subscriptions to the capital stock."

"June 10, 1872. Voted that the treasurer be authorized and instructed to obtain such legal counsel as he may see fit as to the proper legal manner to be pursued to collect unpaid assessments to the capital stock, and also as to the legal status of the corporation." The defendant, at the close of the evidence, moved to dismiss on the ground that the suit was not authorized by a vote of the directors of said company, or by any legal authority. This motion was overruled by the judge.

There was evidence tending to show that in December, 1870, the defendant signed the agreement declared upon; that the act of incorporation was passed on March 3, 1871; that the corporation was duly organized on March 18, 1871, and that the name of the defendant was entered on the books of the corporation as a stockholder and notices were issued and directed to him of all the meetings.

The defendant then asked the judge to instruct the jury that if they were satisfied upon the evidence that the defendant never attended any meeting of the corporation at the time of its organization, or after its organization, the action could not be maintained, although the corporation still retained his name upon its books, and sent him notices of the meetings; that it was not enough for the plaintiff to show that it retained Carey's name upon its books, and otherwise considered him as entitled to a share in the capital stock, unless they are also satisfied that Carey did some act after its organization in ratification of his agreement.

The judge refused to give these instructions, but instructed the jury that if the plaintiff entered the defendant's name on the books of the corporation, as a stockholder, issued and directed notices to him of all its meetings, and gave him the same opportunities to attend the meetings and participate in the proceedings thereof as were given to other stockholders, they were authorized to find that the defendant's offer was accepted, and that he was received as a member of the corporation. The jury found for the plaintiff, and the defendant alleged exceptions.

WELLS, J. In agreements of this nature, entered into before the organization is formed, or the agent constituted to receive the amounts subscribed, the difficulty is to ascertain the promisee, in whose name alone suit can be brought. The promise of each subscriber, "to and with each other," is not a contract capable of being enforced, or intended to operate literally as a contract to be enforced between each subscriber and each other who may have signed previously, or who should sign afterwards, nor between each subscriber and all the others collectively as individuals. The undertaking is inchoate and incomplete as a contract until the contemplated organization is effected, or the mutual agent constituted to represent the association of individual rights in accepting and acting upon the propositions offered by the several subscriptions. When thus ac-

cepted, the promise may be construed to have legal effect according to its purpose and intent, and the practical necessity of the case; to wit, as a contract with the common representative of the several associates.

In *Thompson* v. *Page*, 1 Met. 565, and *Ives* v. *Sterling*, 6 Met. 310, individuals subsequently selected by voluntary associations to receive and expend subscriptions, in accordance with the terms of the agreement of association, were allowed to maintain actions against individual subscribers for the amount of their several subscriptions. Being thus constituted the payees, they were construed to have become also the promisees under the written agreement. The same principle applies where the agreement contemplates the organization of a corporation, and refers the payment of the subscriptions to the proper officers of such corporation. See *People's Ferry Co.* v. *Balch*, 8 Gray, 303, 311.

In this agreement the treasurer of the corporation to be established is expressly made payee. The corporation is the aggregate of the several individuals entering into the agreement, one of whose terms was that they should thus associate and confer their individual rights upon the corporation. We are of opinion that the corporation, and the corporation alone, is the proper party to bring an action upon such an agreement.

The corresponding agreements of the other subscribers, the organization of the corporation, and the allotment to the defendant of the shares for which he subscribed, furnish sufficient consideration for his promise to take and pay for those shares. Although his promise was originally voluntary, or in the nature of a mere open proposition, yet having been accepted and acted on by the party authorized so to do, before he attempted to retract it, he has lost the right to revoke. His proposition has become an accepted mutual contract, and is binding upon him as well as upon the corporation. The votes of the corporation indicate sufficient authority for the institution of this suit in the corporate name and behalf.

These considerations dispose of all the objections, taken in various forms, to the maintenance of the action.

Exceptions overruled.

NOTE. — See, in *accord* as to the result, *Planters & Merchants Co.* v. *Webb*, 144 Ala. 666; *Horseshoe Pier Co.* v. *Sibley*, 157 Cal. 442 (promise to subscribe made to a trustee; corporation, when formed, may maintain action thereon as real party in interest); *Richelieu Hotel Co.* v. *International Encampment Co.*, 140 Ill. 248 (cf. *Thrasher* v. *Pike County R.R. Co.*, 25 Ill. 393); *Hughes* v. *Antietam Mfg. Co.*, 34 Md. 316; *International Fair Association* v. *Walker*, 83 Mich. 386; *Yonkers Gazette Co.* v. *Taylor*, 30 N.Y. App. Div. 334 (cf. *Avon Springs Sanitarium Co.* v. *Weed*, 189 N.Y. 557, reversing 119 App.

Div. 560, on the dissenting opinion of McLENNAN, P.J.); *Greater Pittsburgh Real Estate Co.* v. *Riley*, 210 Pa. 283 (incorporator held to his statements in a certificate for charter); *Steely* v. *Texas Improvement Co.*, 55 Tex. Civ. App. 463. Cf. *Coppage* v. *Hutton*, 124 Ind. 401; *Mt. Sterling Coal Road Co.* v. *Little*, 14 Bush (Ky.) 429.

If the defendant simply agreed with a promoter to apply for a certain proportion of the shares of a new company not taken by the public, he may refuse to become a member of the company, merely exposing himself to liability for any damages which the promoter may have sustained from such breach of contract. *Electric Welding Co.* v. *Prince*, 195 Mass. 242, 254.

BRYANT'S POND STEAM MILL CO. *v.* FELT.

87 Me. 234. 1895.

ON REPORT.

This was an action of assumpsit brought to recover of the defendant the sum of two hundred dollars as appeared by his alleged subscription upon an original subscription book, and upon the outer cover of which was the following writing, "Subscription for a steam mill to be erected at or near Bryant's Pond." The original agreement was as follows:

"We, the undersigned, hereby agree to pay for the number of shares set opposite our names, said shares to be ten dollars each, and non-assessable, for the purpose of erecting suitable buildings, with steam power, for the manufacturing of the various kinds of wood to be used in the contract of one C. H. Adams, he paying three per cent annually as rent on all money so paid, said monies to be paid when needed for the purpose above named, providing the town will abate taxes on said buildings and stock for the term of ten years."

WALTON, J. The only question we find it necessary to consider is whether a subscriber to the capital stock of an unorganized corporation has a right to withdraw from the enterprise, provided he exercises the right before the corporation is organized and his subscription is accepted. We think he has. Such a subscription is not a completed contract. It takes two parties to make a contract. A non-existing corporation can no more make a contract for the sale of its stock than an unbegotten child can make a contract for the purchase of it.

The right of subscribers to the capital stock of a proposed corporation to withdraw their subscriptions at any time before the organization of the corporation is completed has been affirmed in several recent and well considered opinions. The right rests upon the impregnable ground of the legal impossibility of completing a

contract between two parties only one of which is in existence. There can be no meeting of the minds of the parties. There can be no acceptance of the subscriber's proposition to become a stockholder. There can be no mutuality of rights or obligations. There can be no consideration for the subscriber's promise. As said in one of our own decisions, it is a mere *nudum pactum*, — a promise without a promisee, — a contractor without a contractee. In fact, every element of a binding contract is wanting. If the subscriber's promise to take and pay for shares remains unrevoked till the organization of the proposed corporation is effected, and his promise has been accepted, then we have all the elements of a valid contract. Competent parties. Mutuality of duties and obligations. A valid consideration, the promise of one party being a sufficient consideration for the promise of the other. A promisee as well as a promisor. A contractee as well as a contractor. In fact, all the elements of a valid contract are present, and the subscription has become binding upon both of the parties. But, till the corporation has come into existence, all these elements are necessarily wanting, and the subscriber's promise amounts to no more than an offer, which, like all mere offers, may be withdrawn at any time before acceptance. When accepted, it becomes binding. Till accepted, it remains revocable. This conclusion is sustained by reason and authority.

In *Starrett* v. *Rockland Co.*, 65 Maine, 374, the plaintiff sought to recover a portion of the dividends of a successful insurance company. He had subscribed for five shares of the stock before the organization of the company was effected; but the evidence of acceptance of his subscription by the corporation after its organization was not satisfactory; and the court held that without such acceptance there was no completed or binding contract; that the minds of the parties never met; that the plaintiff's subscription, being made before the corporation came into existence, amounted to no more than a proposal to take so many shares, — a mere *nudum pactum*, — imposing no obligations and securing no rights.

And in *Carr* v. *Bartlett*, 72 Maine, 120, the right of subscribers to withdraw from such undertakings while they remain inchoate and incomplete is recognized and affirmed.

. In *Muncy Traction Engine Co.* v. *Green*, 143 Pa. St., 269; 13 At. Rep. 747, decided in 1888, the defendant had been active in procuring subscribers to the capital stock of a proposed corporation, and had himself subscribed for twenty shares: but he wrote to the chairman of the meeting for the organization of the corporation that, for reasons satisfactory to himself, he withdrew his subscription. The court ruled that the defendant had a right to withdraw his subscription at any time before the organization of the corporation was completed; and the jury having found as a matter of fact that the withdrawal was before the organization of the corporation was completed,

a verdict for the defendant was affirmed, and judgment rendered thereon.

In *Hudson Real Estate Co.* v. *Tower*, 156 Mass. 82 (1892), the action was founded on a subscription to the capital stock of an unorganized corporation, and the defense was based on an alleged withdrawal of the subscription. The right to withdraw was controverted. The court held that at the time when the defendant signed the subscription paper declared on, it was not a contract, for want of a contracting party on the other side; that while such a subscription may become a contract after the corporation has been organized, still, until the organization is effected, and the subscription is accepted, it is a mere proposition or offer, which may be withdrawn, like any other unaccepted proposition or offer.

It is urged by the counsel for the plaintiff corporation that such subscriptions create binding and enforceable contracts between the subscribers themselves, and are therefore irrevocable, except with the consent of all the subscribers; and some of the authorities cited by him seem to sustain that view. But we find, on examination, that such views, when expressed, are in most cases mere dicta, and that the cases are very few in which such a doctrine has been acted upon. Reason and the weight of authority are opposed to such a view. Of course, subscription papers may be so worded as to create binding contracts between the subscribers themselves. But we are not now speaking of such subscriptions; or of voluntary and gratuitous subscriptions to public or charitable objects, which, when accepted and acted upon, become binding. We are now speaking only of subscriptions to the capital stock of proposed business corporations. With regard to such subscriptions, we regard it as settled law that they do not become binding upon the subscribers till the corporations have been organized and the subscriptions accepted; and that, till then, the subscribers have a right to revoke their subscriptions. And, in view of the fact that such subscriptions are often obtained by over persuasion, and upon sudden and hasty impulses, we are not prepared to say that the rule of law which allows such a revocation is not founded in wisdom. We think it is.

In the present case, an old man, upwards of eighty years of age, and now dead, was induced to subscribe for twenty shares of stock in a proposed, but not then organized, manufacturing corporation; but after a little reflection, he determined to revoke his subscription and withdraw from the enterprise. He notified the agent of the promoters, through whom his subscription had been obtained, of his determination to withdraw, and requested him to take his name off the subscription paper. And he again sent word by his son to have his name taken off. And notice of his withdrawal, and of his request to have his name taken off of the subscription paper, was given to the other subscribers at one of their meetings, and before the cor-

poration was organized. We think his withdrawal was legal and complete, and that no action to recover the amount of his subscription is maintainable.

Other grounds are urged in defense of the action, but it is unnecessary to consider them.

Judgment for defendant.

NOTE. — But in *Minneapolis Machine Co.* v. *Davis*, 40 Minn. 110, MITCHELL, J., said (p. 114): "A subscription by a number of persons to the stock of a corporation to be formed by them has in law a double character: *First.* It is a contract between the subscribers themselves to become stockholders without further act on their part immediately upon the formation of the corporation. As such a contract it is binding and irrevocable from the date of the subscription (at least in the absence of fraud or mistake), unless cancelled by consent of all the subscribers before acceptance by the corporation. *Second.* It is also in the nature of a continuing offer to the proposed corporation, which, upon acceptance by it after its formation, becomes as to each subscriber a contract between him and the corporation."

CARMICHAEL'S CASE.

[1896.] 2 Ch. 643.

THIS was an appeal by Carmichael from a decision of STIRLING J., refusing an application to strike his name out of the register of shareholders.

The company was brought out in February, 1896, and was formed to purchase from Mr. C. B. Phillips and work certain mining property of his. The price was 145,000*l*. The company was to have a nominal capital of 175,000*l*. in 1*l*. shares. The purchase-money was to be paid, as to 58,333*l*. in fully paid-up shares, as to 30,000*l*. in cash, and as to 56,667*l*. in cash or shares.

On February 21, 1896, Carmichael signed an underwriting contract in the form of a letter addressed to Phillips: "I agree, for the consideration below stated, to subscribe for 1000 shares of the above issue, and to pay for the same on the conditions named in the prospectus, or any modification thereof, or of the title of the company, or the directors or officers, so long as the capital of the company and the purchase price of the property are not altered; and I hereby enclose my application for such shares and a cheque for 2*s*. 6*d*. per share deposit in respect of such shares, which deposit I authorize and request you to pay over to the above-named company; and I undertake to pay the further moneys payable in respect of any shares

I have to take up under the terms of this contract. If, on or before the public issue of the prospectus, there are 60,000 shares of the above issue bonâ fide and duly applied for by the public, then no allotment is to be made to me in respect of this agreement, and my application and the said deposit is to be forthwith returned to me by the said company. If less than such 60,000 shares are applied for by the public, then I am only to be allotted my proportion of the deficiency between the amount so subscribed for by the public and such 60,000 shares, pro ratâ with any other persons who have signed or may sign underwriting contracts in connection with the above issue. If on the public issue of the prospectus, and before the closing of the list, I deliver to you applications for shares from responsible persons to your satisfaction, such applications shall go primarily in relief of my obligation under this contract. In either case, I am to receive from you a commission of 7½ per cent. in cash and 7½ per cent. in fully paid shares of the said company upon the total shares hereby underwritten by me within fourteen days after the completion of the purchase by the above company, if the whole of such 60,000 shares are applied for by the public; but in the event of the public not applying for the whole of such 60,000 shares, then such commission is to be payable by you within fourteen days after payment by me to the company of the allotment-money in respect of my proportion of the deficiency of such shares, or the completion of the purchase by the above company, whichever event shall be last; and I authorize you, if you think fit so to do, to apply my said commission or any part thereof in payment to the company of or on account of the said allotment-moneys. I further agree that this agreement and my said application shall be irrevocable on my part, and shall, notwithstanding any withdrawal on my part or any repudiation of my responsibility hereunder or thereunder, be sufficient to authorize and empower you to make any further or other application on my behalf, and also be sufficient to authorize and empower the directors of the company to allot to me the beforementioned shares, and to enter my name on the register of members in respect thereof."

On February 22 Carmichael signed and handed in an application for 1000 shares, and gave a cheque payable to the company for 125*l.*, the amount of the deposit payable on application.

On the same day Phillips sent to Carmichael a letter headed with the name of the company: "I accept your underwriting contract on the terms mentioned to the extent of 1000 shares. C. B. Phillips."

On March 24 the company was incorporated, and advertisements were issued stating that the subscription list would open on the 27th and close on the 30th of that month.

On the 27th Carmichael directed his bankers not to pay the cheque, which accordingly they refused to pay. On the 30th he wrote to

Phillips repudiating his underwriting contract, and on the same day wrote to the secretary of the company the following letter: "Please take notice that I withdraw my underwriting in above company, and withdraw any authority contained in the underwriting letter to apply for any shares on my behalf."

At a board meeting of directors on April 2 the secretary produced the last-mentioned letter. Mr. Phillips, who was present, then produced the underwriting letter, insisted that Carmichael had no right to withdraw, and handed in on his behalf a fresh application for 980 shares in pursuance of the underwriting contract, that being the number which, according to the contract, ought, in the events which had happened, to be allotted to him. They were accordingly allotted to him, and he was placed on the register in respect of them.

Stirling, J., held that the authority given to Phillips by the underwriting letter was an authority coupled with an interest, and therefore irrevocable. His Lordship, therefore, refused to remove Carmichael's name from the register. Carmichael appealed.

Lindley, L.J. I do not think there is any difficulty in this case. Mr. Bramwell Davis has asked us to treat this as a complex transaction consisting of two parts — one a contract and one an authority, and he says, "Although I agree that I cannot revoke my contract, still I am at liberty to revoke my authority." Now, I do not mean to say that there may not be cases as to which that contention would be well founded; but when we look at this case and see the purpose for which the authority is given and the object of it, which is to enable a contract to be performed in which Mr. Phillips was interested, his argument will not hold. Let us look at the document itself. It is a letter, or, as it is called, an underwriting contract. Of course, it is not a contract until it is accepted. It is addressed to Mr. Phillips, the vendor of some property to this company, who was to be paid out of money raised by the issue of shares. He had, therefore, a clear and direct interest in raising the capital, out of which he was to be paid, and Mr. Carmichael knew that. That is common ground. Under these circumstances he signs this document, which is called an underwriting contract, and it is addressed to Mr. Phillips. It is in these terms: [His Lordship read the material parts of the document down to the last clause.]

Then comes this clause, which is very important: "I further agree that this agreement and my said application shall be irrevocable on my part, and shall, notwithstanding any withdrawal on my part or any repudiation of my responsibility hereunder or thereunder, be sufficient to authorize and empower you to make any further or other application on my behalf, and also be sufficient to authorize and empower the directors of the company to allot to me the before-mentioned shares, and to enter my name on the register of members in respect thereof." Now, what is the true meaning of that? It is

part of a bargain by which, for valuable consideration, Mr. Carmichael agrees to take certain shares, and that is for the benefit of Mr. Phillips as he knows; and in order to enable Mr. Phillips the better to secure the performance of the contract Mr. Carmichael authorizes Mr. Phillips to apply for shares in his name, and he agrees not to revoke that authority even if he could do it without such a clause. Now, Mr. Phillips acted with perfect bona fides, and upon the terms of that authority he does apply in Mr. Carmichael's name for 980 shares, which are allotted to him. Why is Mr. Carmichael not to be held a member of this company? Can it under the circumstances be said, in the language of § 35 of the Companies Act, 1862, that his name is "without sufficient cause entered in the register of members"? It appears to me there is ample cause. The attempt to make out that he is entitled to revoke the authority although he cannot revoke the contract entirely fails.

STIRLING, J., in deciding this case has referred to an observation of WILLIAMS, J., in the case of *Clerk* v. *Laurie*, 2 H. & N. 199, 200, which runs thus: "What is meant by an authority coupled with an interest being irrevocable is this — that where an agreement is entered into on a sufficient consideration, whereby an authority is given for the purpose of securing some benefit to the donee of the authority, such an authority is irrevocable." That is the principle on which STIRLING, J., decided this case, and it appears to me the principle properly applicable to it. The appeal must be dismissed with costs.

LOPES, L.J. The question in this case is whether the company had authority to allot these shares to Mr. Carmichael. That question depends on whether the authority given to Mr. Phillips, who was the vendor, was revocable or not. If it was an authority coupled with an interest, it would be irrevocable. The question that really arises is whether in this case it is an authority coupled with an interest. I think the answer is a very short and a very complete one. What was the object? The object was to enable Mr. Phillips, the vendor, to obtain his purchase-money, and, in the language of WILLIAMS, J., it therefore conferred a benefit on the donee of the authority. I think, therefore, the judgment of STIRLING, J., is perfectly right, and that Mr. Carmichael is a member of this company, and is not entitled to have his name struck out.

CHAPTER II.

CONVEYANCES TO PROMOTERS, AND CONTRACTS WITH PROMOTERS RELATING TO PROPERTY OR SERVICES.

PENNELL *v.* LOTHROP.

191 Mass. 357. 1906.

THE bill was founded upon an agreement in part as follows: "Articles of indenture entered into this fifth day of April, A.D. 1894, by and between Harriet M. Lothrop of Concord, in the County of Middlesex and Commonwealth of Massachusetts, party of the first part and Edmund H. Pennell of Medford in the County of Middlesex, Harry E. Morrell of Hyde Park in the County of Norfolk, and Frank M. Hoyt of Chelsea in the County of Suffolk, all in the Commonwealth of Massachusetts, parties of the second part, Witnesseth: That the said party of the first part in consideration of One Dollar and other valuable considerations to her paid by the said parties of the second part hereby covenants and agrees with said parties of the second part, that she will allow the Lothrop Publishing Company, a corporation to be organized by said parties of the second part under the laws of the State of Maine, the exclusive right to publish in book form all writings of said party of the first part which now are or have been published in any form, and the exclusive right to publish in book form all writings for publication which the said party of the first part shall produce for a period of five years from the date of this instrument if they elect to publish them; otherwise the party of the first part has the right to place them where she chooses."

KNOWLTON, C.J. Let us first consider the contract on which the suit is founded. It is a contract between the defendant and the individual plaintiffs, and not a contract with any corporation. When it was made the Lothrop Publishing Company was not in existence, and could not be a party to a contract. In *Abbott* v. *Hapgood*, 150 Mass. 248, it was said that "if a contract is made in the name and for the benefit of a projected corporation, the corporation after its organization cannot become a party to the contract, even by adoption or ratification of it." This does not mean that after the organization of the corporation it cannot enter into a contract such as previously had been prepared. *Holyoke Envelope Co.* v. *United States Envelope Co.* 182 Mass. 171. *Penn Match Co.* v. *Hapgood*, 141 Mass.

145. *Abbott* v. *Hapgood*, *ubi supra*. Such a contract, as between the corporation and any other party, would have its inception when entered into by the corporation, and would require, to make it valid, the existence of all such elements as are necessary in other contracts.

NOTE. — In *Munson* v. *Syracuse R.R. Co.*, 103 N.Y. 58, ANDREWS, J., said (p. 75): "But the promoters of a corporation are not the corporation. The legal body is distinct from the individuals who compose it. The statute confers no authority upon the promoters of a corporation to enter into preliminary contracts binding the corporation when it shall come into existence. Such contracts may bind the individuals who make them. If adopted by the corporation, and they are within the corporate powers, and are not otherwise subject to objection, they may become the contracts of the corporation and enforceable as such. In respect to contracts of promoters Judge REDFIELD says: 'The promoters are in no sense identical with the corporation, nor do they represent it in any relation of agency, and their contracts could, of course, only bind the company so far as they should be subsequently adopted by it, as their successors.'"

McARTHUR *v.* TIMES PRINTING CO.

48 Minn. 319. 1892.

APPEAL by defendant, Times Printing Company, from an order of the district court of Hennepin County, CANTY, J., made August 4, 1891, denying its motion for a new trial.

Action brought by D. A. McArthur to recover damages sustained by him from the breach of a contract made by defendant with him. He was employed by it for a year from October 1, 1889, to solicit advertisements for its newspaper, and was to receive $20 a week during October, and $30 a week for the residue of the year, and was also to receive, at the end of the year, five shares of its stock, of $100 each. He was discharged April 12, 1890. After the year expired he brought this suit. It was tried May 5, 1891, and plaintiff had a verdict for $450. Defendant moved for a new trial. The motion was denied, and it appealed.

MITCHELL, J. The complaint alleges that about October 1, 1889, the defendant contracted with plaintiff for his services as advertising solicitor for one year; that in April, 1890, it discharged him, in violation of the contract. The action is to recover damages for the breach of the contract. The answer sets up two defenses: (1) that plaintiff's employment was not for any stated time, but only from week to week; (2) that he was discharged for good cause. Upon the trial there was evidence reasonably tending to prove that in Septem-

ber, 1889, one C. A. Nimocks and others were engaged as promoters in procuring the organization of the defendant company to publish a newspaper; that, about September 12th, Nimocks, as such promoter, made a contract with plaintiff, in behalf of the contemplated company, for his services as advertising solicitor for the period of one year from and after October 1st, — the date at which it was expected that the company would be organized; that the corporation was not, in fact, organized until October 16th, but that the publication of the paper was commenced by the promoters October 1st, at which date plaintiff, in pursuance of his arrangement with Nimocks, entered upon the discharge of his duties as advertising solicitor for the paper; that after the organization of the company he continued in its employment in the same capacity until discharged, the following April; that defendant's board of directors never took any formal action with reference to the contract made in its behalf by Nimocks, but all of the stockholders, directors, and officers of the corporation knew of this contract at the time of its organization, or were informed of it soon afterwards, and none of them objected to or repudiated it, but, on the contrary, retained plaintiff in the employment of the company without any other or new contract as to his services.

There is a line of cases which hold that where a contract is made in behalf of, and for the benefit of, a projected corporation, the corporation, after its organization, cannot become a party to the contract, either by adoption or ratification of it. *Abbott* v. *Hapgood*, 150 Mass. 248 (22 N.E. Rep. 907); Beach, Corp. § 198. This, however, seems to be more a question of name than of substance; that is, whether the liability of the corporation, in such cases, is to be placed on the grounds of its adoption of the contract of its promoters, or upon some other ground, such as equitable estoppel. This court, in accordance with what we deem sound reason, as well as the weight of authority, has held that, while a corporation is not bound by engagements made on its behalf by its promoters before its organization, it may, after its organization, make such engagements its own contracts. And this it may do precisely as it might make similar original contracts; formal action of its board of directors being necessary only where it would be necessary in the case of a similar original contract. That it is not requisite that such adoption or acceptance be expressed, but it may be inferred from acts or acquiescence on part of the corporation, or its authorized agents, as any similar original contract might be shown. *Battelle* v. *Northwestern Cement & Concrete Pavement Co.*, 37 Minn. 89 (33 N.W. Rep. 327). See, also, Mor. Corp. § 548. The right of the corporate agents to adopt an agreement originally made by promoters depends upon the purposes of the corporation and the nature of the agreement. Of course, the agreement must be one which the corporation itself could make,

and one which the usual agents of the company have express or implied authority to make. That the contract in this case was of that kind is very clear; and the acts and acquiescence of the corporate officers, after the organization of the company, fully justified the jury in finding that it had adopted it as its own.

The defendant, however, claims that the contract was void under the statute of frauds, because, "by its terms, not to be performed within one year from the making thereof," which counsel assumes to be September 12th, — the date of the agreement between plaintiff and the promoter. This proceeds upon the erroneous theory that the act of the corporation, in such cases, is a ratification, which relates back to the date of the contract with the promoter, under the familiar maxim that "a subsequent ratification has a retroactive effect, and is equivalent to a prior command." But the liability of the corporation, under such circumstances, does not rest upon any principle of the law of agency, but upon the immediate and voluntary act of the company. Although the acts of a corporation with reference to the contracts made by promoters in its behalf before its organization are frequently loosely termed "ratification," yet a "ratification," properly so called, implies an existing person, on whose behalf the contract might have been made at the time. There cannot, in law, be a ratification of a contract which could not have been made binding on the ratifier at the time it was made, because the ratifier was not then in existence. *In re Empress Engineering Co.*, 16 Ch. Div. 128; *Melhado* v. *Porto Alegre, N.H. & B. Ry. Co.*, L.R. 9 C.P. 505; *Kelner* v. *Baxter*, L.R. 2 C.P. 185. What is called "adoption," in such cases, is, in legal effect, the making of a contract of the date of the adoption, and not as of some former date. The contract in this case was, therefore, not within the statute of frauds. The trial court fairly submitted to the jury all the issues of fact in this case, accompanied by instructions as to the law which were exactly in the line of the views we have expressed; and the evidence justified the verdict.

The point is made that plaintiff should have alleged that the contract was made with Nimocks, and subsequently adopted by the defendant. If we are correct in what we have said as to the legal effect of the adoption by the corporation of a contract made by a promoter in its behalf before its organization, the plaintiff properly pleaded the contract as having been made with the defendant. But we do not find that the evidence was objected to on the ground of variance between it and the complaint. The assignments of error are very numerous, but what has been already said covers all that are entitled to any special notice.

Order affirmed.

NOTE. — See, *accord*, *Brautigam* v. *Dean & Co.*, 85 N.J.L. 549; *Pratt* v. *Oshkosh Match Co.*, 89 Wis. 406.

KELNER *v.* BAXTER.

L.R. 2 C.P. 174. 1866.

THE declaration was for goods sold and delivered, goods bargained and sold, interest, and upon accounts stated.

At the trial before ERLE, C.J., at the sittings in London after last Trinity Term, the following facts appeared in evidence: The plaintiff was a wine merchant, and the proprietor of the Assembly Rooms at Gravesend. In August, 1865, it was proposed that a company should be formed for establishing a joint-stock hotel company at Gravesend, to be called the Gravesend Royal Alexandra Hotel Company, Limited, of which the following gentlemen were to be the directors, viz. Mr. L. Calisher, Mr. T. H. Edmands, Mr. M. Davis, Mr. Macdonald, Mr. Hulse, Mr. N. J. Calisher (one of the defendants), and the plaintiff. The plaintiff was to be the manager of the proposed company, and Mr. Dales (another of the defendants) was to be the permanent architect. One part of the scheme was that the company should purchase the premises of the plaintiff for a sum of 5000*l.*, of which 3000*l.* was to be paid in cash, and 2000*l.* in paid up shares, the stock, etc., to be taken at a valuation; and this was carried into effect and completed, the other defendant (Baxter) being the nominal purchaser on behalf of the company. In December a prospectus was settled. On the 9th of January, 1866, a memorandum of association was executed by the plaintiff and the defendants and others.

Pending the negotiations the business had been carried on by the plaintiff, and for that purpose additional stock had been purchased by him; and on the 27th of January, 1866, an agreement was entered into for the transfer of this additional stock to the company, in the following terms: —

"January 27th, 1866.

"To John Dacier Baxter, Nathan Jacob Calisher, and John Dales, on behalf of the proposed Gravesend Royal Alexandra Hotel Company, Limited.

"Gentlemen, — I hereby propose to sell the extra stock now at the Assembly Rooms, Gravesend, as per schedule hereto, for the sum of 900*l.*, payable on the 28th of February, 1866.

(Signed) "JOHN KELNER."

Then followed a schedule of the stock of wines, etc., to be purchased, and at the end was written as follows: —

"To Mr. John Kelner.

"Sir, — We have received your offer to sell the extra stock as above, and hereby agree to and accept the terms proposed.

(Signed) "J. D. BAXTER,
"N. J. CALISHER,
"J. DALES.

"On behalf of the Gravesend Royal Alexandra Hotel Company, Limited."

In pursuance of this agreement the goods in question were handed over to the company, and consumed by them in the business of the hotel; and on the 1st of February a meeting of the directors took place, at which the following resolution was passed: "That the arrangement entered into by Messrs. Calisher, Dales, and Baxter, on behalf of the company, for the purchase of the additional stock on the premises, as per list taken by Mr. Bright, the secretary, and pointed out by Mr. Kelner, amounting to 900*l.*, be, and the same is hereby ratified." There was also a subsequent ratification *by the company*, viz. on the 11th of April, but this was after the commencement of the action.

The articles of association of the company were duly stamped on the 13th of February, and on the 20th the company obtained a certificate of incorporation under the 25 & 26 Vict. c. 89.

The company having collapsed, the present action was brought against the defendants upon the agreement of the 27th of January.

On the part of the defendants oral evidence was tendered for the purpose of showing that it never was intended that they should be personally liable; but his Lordship rejected it. It was then submitted that, inasmuch as the agreement was not entered into by the defendants personally, but only as agents for the hotel company, they thereby incurred no personal obligation to the plaintiff, who was himself one of the promoters.

For the plaintiff it was insisted that, there being no company in existence at the time of the agreement, the parties thereto had rendered themselves personally liable; and that there could be no ratification of the contract by a subsequently created company.

A verdict was taken for the plaintiff for 900*l.*, subject to leave reserved to the defendants (upon giving security) to move to enter a nonsuit, on the ground that the agreement of the 27th of January did not make them personally liable.

ERLE, C.J. I am of opinion that this rule should be discharged. The action is for the price of goods sold and delivered: and the question is whether the goods were delivered to the defendants under a contract of sale. The alleged contract is in writing, and commences with a proposal addressed to the defendants, in these words: "I hereby propose to sell the extra stock now at the Assembly Rooms, Gravesend, as per schedule hereto, for the sum of 900*l.*, payable on the 28th of February, 1866." Nothing can be more distinct than this as a vendor proposing to sell. It is signed by the plaintiff, and is followed by a schedule of the stock to be purchased. Then comes the other part of the agreement, signed by the defendants, in these words, "Sir, We have received your offer to sell the extra stock as above, and hereby agree to and accept the terms proposed." If it had rested there, no one could doubt that there was a distinct proposal by the vendor to sell, accepted by the purchasers. A difficulty

has arisen because the plaintiff has at the head of the paper addressed it to the plaintiffs "on behalf of the proposed Gravesend Royal Alexandra Hotel Company, Limited," and the defendants have repeated those words after their signatures to the document, and the question is, whether this constitutes any ambiguity on the face of the agreement, or prevents the defendants from being bound by it. I agree that if the Gravesend Royal Alexandra Hotel Company had been an existing company at this time, the persons who signed the agreement would have signed as agents of the company. But, as there was no company in existence at the time, the agreement would be wholly inoperative unless it were held to be binding on the defendants personally. The cases referred to in the course of the argument fully bear out the proposition that, where a contract is signed by one who professes to be signing "as agent," but who has no principal existing at the time, and the contract would be altogether inoperative unless binding upon the person who signed it, he is bound thereby: and a stranger cannot by a subsequent ratification relieve him from that responsibility. When the company came afterwards into existence it was a totally new creature, having rights and obligations from that time, but no rights or obligations by reason of anything which might have been done before. It was once, indeed, thought that an inchoate liability might be incurred on behalf of a proposed company, which would become binding on it when subsequently formed: but that notion was manifestly contrary to the principles upon which the law of contract is founded. There must be two parties to a contract; and the rights and obligations which it creates cannot be transferred by one of them to a third person who was not in a condition to be bound by it at the time it was made. The history of this company makes this construction to my mind perfectly clear. It was no doubt the notion of all the parties that success was certain: but the plaintiff parted with his stock upon the faith of the defendants' engagement that the price agreed on should be paid on the day named. It cannot be supposed that he for a moment contemplated that the payment was to be contingent on the formation of the company by the 28th of February. The paper expresses in terms a contract to buy. And it is a cardinal rule that no oral evidence shall be admitted to show an intention different from that which appears on the face of the writing. I come, therefore, to the conclusion that the defendants, having no principal who was bound originally, or who could become so by a subsequent ratification, were themselves bound, and that the oral evidence offered is not admissible to contradict the written contract.

WILLES, J. I am of the same opinion. Evidence was clearly inadmissible to show that the parties contemplated that the liability on this contract should rest upon the company and not upon the persons contracting on behalf of the proposed company. The utmost it

could amount to is, that both parties were satisfied at the time that all would go smoothly, and consequently that no liability would ensue to the defendants. The contract is, in substance, this, "I, the plaintiff, agree to sell to you, the defendants, on behalf of the Gravesend Royal Alexandra Hotel Company, my stock of wines;" and, "We, the defendants, have received your offer, and agree to and accept the terms proposed; and you shall be paid on the 28th of February next." Who is to pay? The company, if it should be formed. But, if the company should not be formed, who is to pay? That is tested by the fact of the immediate delivery of the subject of sale. If payment was not made by the company, it must, if by anybody, be by the defendants. That brings one to consider whether the company could be legally liable. I apprehend the company could only become liable upon a new contract. It would require the assent of the plaintiff to discharge the defendants. Could the company become liable by a mere ratification? Clearly not. Ratification can only be by a person ascertained at the time of the act done, — by a person in existence either actually or in contemplation of law; as in the case of assignees of bankrupts and administrators, whose title, for the protection of the estate, vests by relation. The case of an executor requires no such ratification, inasmuch as he takes from the will. It is unnecessary, however, to pursue this further. In addition to the cases cited at the bar, I would refer to *Gunn* v. *London and Lancashire Fire Insurance Company*, 12 C.B. N.S. 694 (E.C.L.R. vol. 104), where this Court, upon the authority of *Payne* v. *New South Wales Coal and International Steam Navigation Company*, 10 Ex. 283, 24 L.J. Ex. 117, held that a contract made between the projector and the directors of a joint-stock company provisionally registered, but not in terms made conditional on the completion of the company, was not binding upon the subsequent completely registered company, although ratified and confirmed by the deed of settlement: and WILLIAMS, J., said that "to make a contract valid, there must be parties existing at the time who are capable of contracting." That is an authority of extreme importance upon this point; and, if ever there could be a ratification, it was in that case. Both upon principle and upon authority, therefore, it seems to me that the company never could be liable upon this contract: and, as was put by my Lord, construing this document ut res magis valeat quam pereat, we must assume that the parties contemplated that the persons signing it would be personally liable. Putting in the words "on behalf of the Gravesend Royal Alexandra Hotel Company," would operate no more than if a person should contract for a quantity of corn "on behalf of my horses." As to the suggestion that there should have been a special count, that is quite a mistake. There need not be a special count unless there was a person existing at the time the contract was made

who might have been principal. The common count perfectly well represents the character of the liability which these defendants incurred. It is quite out of the question to suppose that there was any mistake. The document represents the real transaction between the parties. I think that the course taken at the trial was perfectly correct, and that the rule should be discharged.

HECKMAN'S ESTATE.

172 Pa. 185. 1896.

OPINION BY MR. JUSTICE WILLIAMS.

This case depends upon the inferences to be drawn from the evidence submitted to the orphans' court. The auditing judge reached one conclusion while his associates reached the opposite one, and it becomes necessary to inquire whether the evidence fairly sustains the decree made by the majority of that court. It appears that several persons, among whom where Heckman and Shafto, had arranged to organize a company for the manufacture and sale of brick. Shafto was the only one of the number who was an experienced brickmaker, and his judgment as to the preliminary arrangements, including the selection of materials and the location of a brickyard, was relied on by all his associates. He was at the same time the agent of Ward, employed by him to secure a tenant for a brickyard owned by him, with the promise that he should have one quarter of the rent obtained. Under these circumstances he directed the attention of his associates to Ward's property, proposing a lease of the yard and of the right to take the clay, to be paid for by a royalty of one dollar per thousand bricks, with a minimum royalty of twenty-five hundred dollars for the first year and four thousand per annum thereafter. Two or three of his associates, including Heckman, visited the property at his instance. The brick company had not been organized. A meeting was brought about by Shafto between Ward and his own associates in the brick enterprise, which resulted in a lease upon the terms Shafto had proposed.

Heckman was to become the president of the company when it was fully organized, and the lease was executed by him on behalf of the company then in process of formation, and as soon as the company was in condition to take it he assigned it directly to the corporation. This was done in pursuance of an understanding to which his associates, including Shafto, the agent of the lessor, were parties. The bills were thereafter made to the Philadelphia Brick Company, presented to its officers, and paid, except in one instance, by its checks.

Under the circumstances disclosed by the evidence we think the

knowledge of Shafto was notice to his principal that the tenant of the yard and the purchaser of the clay was the corporation and not any member or officer thereof; that the corporation was the prospective operator and owner of the works, and was to be looked to for the rents or royalties. The subsequent course of dealing would indicate actual knowledge of the facts, and recognition of the relation of lessor and lessee between himself and the corporation on the part of Ward.

We are not prepared to adopt the conclusion reached by the court below that the bad faith of Shafto in his dealings with his associates rendered the contract he had negotiated between them and his employer absolutely void. As to any right of action or interest of his own, that result might well follow; but we can see no reason why the lessor should not recover for his royalties, at least as to so much thereof as he was actually to receive. It is not necessary however to enter upon that subject. We place the affirmance of this judgment on the ground already indicated. The agent negotiated this lease. He knew perfectly well who was to be the lessee, and by whom the enterprise was to be conducted. He was himself a member of the company for whose use and benefit Heckman became temporarily a substitute; and it would have been a fraud on Heckman for Shafto to attempt to hold him personally responsible for what he well knew was understood to be the obligation of the corporation. The principal cannot secure the benefit of the contract and repudiate the means by which its execution was induced. He stands on the ground on which his agent has put him.

The assignments of error are overruled and the decree is affirmed.

NOTE. — See, *accord*, *Chicago Building Co.* v. *Talbolton Creamery Co.*, 106 Ga. 84. Cf. *Furniture & Carpet Co.* v. *Crawford*, 127 Mo. 356.

WEATHERFORD RY. CO. *v.* GRANGER.

86 Tex. 350. 1894.

GAINES, ASSOCIATE JUSTICE. This suit was brought by the defendant in error against the plaintiff in error to recover upon open account for services rendered. The plaintiff in the trial court obtained a judgment, which was affirmed by the Court of Civil Appeals. This writ of error is sued out for the purpose of reversing that judgment.

The plaintiff in error, the defendant in the trial court, is a corporation, organized under the general law of the State for the purpose of constructing and operating a railroad. The defendant in

error, the plaintiff in the trial court, is a practicing attorney at law. The services for which a recovery was sought were for aiding to raise a bonus and for legal advice and assistance, and were rendered both before and after the filing with the Secretary of State the company's articles of incorporation.

The testimony, as shown by the statement of facts, in so far as it bears upon the question before the court, is in substance as follows:

The plaintiff testified, that in March, 1889, he was employed by one Anderson to assist in raising a bonus for the defendant company, and "agreed that the said company would pay him well for his services;" that Anderson was a promoter of the corporation, and represented himself as its general manager, and employed plaintiff not only to assist in procuring the bonus, but to attend to all the company's business as its attorney; that in September, 1889, Anderson allowed his account, and was at that time the owner of a majority of the stock, which he subsequently transferred to one Stone, the president of the company, and his associates.

Stone testified, on behalf of the company, that in the spring of 1889, in Kansas City, Missouri, he employed Anderson to go to Weatherford, and to procure a bonus of $40,000 and survey the right of way for a railroad from that city to Mineral Wells, and to pay him $1000 for his services; that he had paid Anderson according to his agreement; that he did not know that Anderson had ever employed plaintiff for any purpose; that Anderson was never general manager for the company, and held no office in it except that of director; that he knew that the plaintiff was interesting himself in procuring the bonus, but supposed he was working for one Johnson, who was one of the charter members, and who owned certain coal lands which he wished to sell to the projectors of the railroad; that plaintiff never said anything to him about the company owing him anything, and that the first he knew of plaintiff's claim was when this suit was brought.

There was further testimony tending to show, that Anderson was the chief active promoter of the enterprise, and that he had the principal management of the business from its inception in March until he retired in September, 1889; and that during this time the plaintiff was frequently in attendance upon him, aiding and assisting him in procuring the bonus, and otherwise promoting the objects of the company.

No controversy is raised in this court as to the fact of plaintiff's services, or as to their value.

The trial judge, as conclusions of fact, found, in substance, that some kind of a company was formed to build the railway from Weatherford to Mineral Wells; that Anderson was "the principal mover in said scheme, and was so recognized by all parties;" that he employed plaintiff to assist him in procuring a bonus and in

otherwise advancing the enterprise, and that the plaintiff rendered service under said employment, both before and after the articles of the company were filed; that the bonus was raised, and was, after its incorporation, accepted by said company.

The Court of Civil Appeals adopt the findings of the trial judge, and add additional findings as follows: "The charter of the defendant company was signed and acknowledged about June 1, 1889, and was filed in the office of the Secretary of State at Austin, July 2, 1889. The bonus or subsidy was not secured until after the filing of the charter. The record would have justified the trial court, and so justifies us, in finding, as we do, the fact to be, that in availing itself of the subsidy secured, the company knew of the services of the plaintiff in raising the bonus."

Under the statute, the corporation came into existence when its articles of incorporation were filed in the office of Secretary of State. Rev. Stats., arts. 4104, 4105. Although the trial court found that the services for which plaintiff sued were rendered in part before and in part after the filing of the articles, their value was assessed as an entirety at $500, and judgment was rendered for the whole amount. In this there was error. We are of opinion, that under the circumstances of this case, as shown by the evidence, the defendant corporation can not be held liable to the plaintiff for any services rendered by him before it was brought into legal existence.

Upon the question as to the liability of a corporation growing out of contracts made on its behalf by its promoters, there is considerable diversity and some conflict of opinion. But there are some propositions affecting this question upon which the authorities seem to be in substantial accord. A promoter, though he purport to act on behalf of the projected corporation, and not for himself, can not be treated as agent, because the nominal principal is not then in existence; and hence when there is nothing more than a contract by a promoter, in which he undertakes to bind the future corporation, it is generally conceded that it can not be enforced. *Kelner* v. *Baxter*, L.R. 2 Com. Pl. 174; *Melhado* v. *Railway*, L.R. 9 Com. Pl. 503.

The promoters themselves are liable upon the contract, unless the person with whom they engage agrees to look to some other fund for payment. *Kerridge* v. *Hesse*, 9 Carr. & P. 200.

The statute, however, which authorizes the incorporation may provide that the corporation, when formed, shall pay the necessary expenses of promoting the scheme; in such a case, though the right of action is dependent upon the contract, the liability is created by the statute. *Re Rotherham, etc., Co.*, L.T. Rep. N.S. 217.

It is now held in England, that although the articles of association bind the company to pay the expenses of its promotion, a third party can not avail himself of such a provision so as to maintain an action

against the company. *Re Rotherham, etc., Co., supra; Eley* v. *Assurance Co.*, 34 L.T. Rep. N.S. 190.

It is also generally held, that contracts by promoters made on behalf of the corporation, within the scope of its general authority, may be adopted by the latter after its organization. Some of the courts say they may be ratified; but ratification presupposes a principal existing at the time of the agent's action, and it seems to us, therefore, that the term is not applicable in its technical sense. *McArthur* v. *Printing Co.*, 51 N.W. Rep. 215; *Spiller* v. *Paris Skating Rink Co.*, 7 Ch. Div. 368.

With the exception of the law courts of England, the rule is also very generally recognized, that if a contract be made on behalf of a corporation by its promoters, and the corporation, after its organization, with a knowledge of the facts, accept its benefits, it must take it with its burdens; and if the other party has performed the stipulation binding upon him, it may be enforced as against the corporation. *Spiller* v. *Rink Co., supra; Loucke* v. *Warehousing Co.*, 6 Ch. 67.

But as to the application of the rule last announced, the courts differ in opinion. A leading case upon this subject is *Edwards* v. *Grand Junction Railway Company*, 1 Milne & Cr. 650. There the promoters of the railway company had entered into a contract with the trustees of a turnpike company, in which the latter agreed to withdraw their opposition to an act of Parliament for the incorporation of the railway company, in consideration of an agreement by the promoters to insert certain clauses in the act as to the nature of the necessary constructions at the crossing of the railway and the turnpike road, and the opposition was withdrawn, but the clauses were not inserted; and it was held, that the railway company should be enjoined from constructing the crossing in a manner different from that specified in the clauses which had been agreed upon and had been omitted. The correctness of the ruling in this case was seriously questioned in the House of Lords in *Preston* v. *Railway*, 5 House of Lords, 605, and in *Caledonian Railway Company* v. *Helensburgh*, 2 McQuean, 391; same case, 2 Jur. N.S. 695. We presume the doubt as to this case arises from the fact that the only benefit accepted by the defendant company was the exercise of the powers conferred upon it by the act of Parliament.

When the promoters of a railway company have agreed with a landed proprietor through whose estates the road is projected to run, to take the requisite quantity of his land at a stipulated price, and after the corporation is formed it takes the land, it is certainly equitable that the company should be made to pay the agreed compensation; and the doctrine is recognized in many English equity cases. *Stanley* v. *Railway*, 3 Milne & Cr. 773; *Gooday* v. *Colchester Railway Co.*, L.R. 15 Eq. 596; *Preston* v. *Liverpool Railway Co.*, L.R. 7 Eq. 124; *Edwards* v. *Grand Junction Railway Co.*, 1 Milne & Cr. 650.

The same *rule* has been announced also in many American cases. *Little Rock Railway Co.* v. *Perry*, 37 Ark. 164; *Paxton Cattle Co.* v. *Bank*, 21 Neb. 621; *Grape Sugar Co.* v. *Small*, 40 Md., 395; *Bommer* v. *Manufacturing Co.*, 81 N.Y. 468; *Battelle* v. *Pavement Co.*, 37 Minn. 89; *McArthur* v. *Printing Co., supra.*

Having exercised rights and enjoyed benefits secured to it by the terms of a contract made by its promoters in its behalf, a corporation should be held estopped to deny its validity.

Again, when the promoters of a corporation have made a contract in its behalf, to be performed after it is organized, it may be deemed a continuing offer on part of the other party to the agreement, unless withdrawn by him, and may be accepted and adopted by the corporation after such organization; and the exercise of any right inconsistent with the non-existence of such contract might be deemed conclusive evidence of such adoption.

But there are some cases which go a step further. *Low* v. *Railway*, 45 New Hampshire, 370, was a case of a Vermont corporation sued in New Hampshire upon a contract made in the former State. After a charter had been granted, but before an organization had been effected, a public meeting was held to promote the enterprise, at which, it is to be presumed from the opinion, the corporators were present or were represented. A proposition was made that the plaintiff should be employed and paid to visit various towns and cities to interest capital in the projected scheme, and to solicit and procure subscriptions. The plaintiff accepted the offer and performed the services, and it was held that the corporation was liable. The court determined that the question of liability depended upon the law of Vermont, as announced in the case of *Hall* v. *Railway*, 28 Vermont, 401. But they were also inclined strongly to think, that upon general principles the company, by accepting subscriptions which were procured by the plaintiff, bound itself to pay for his services. They also seem to recognize the doctrine, that after a charter has been granted a majority of the corporators have the power to make contracts necessary to perfect the organization, which may be binding upon the company when formed. But they also lay stress upon the fact that the charter of the defendant corporation provided, that "the expenses of all surveys and examinations, as also of the preliminary surveys already made and making, and all manner of incidental expenses relating thereto, shall be paid by said corporation."

In *Hall* v. *Railway*, *supra*, a corporator was held entitled to recover for necessary services in organizing the company, although there was no express promise by any one that he should be paid. Unless the charter of the company provided for the payment of such expenses, this decision we think is unsupported by authority.

It is generally held, that in the absence of such provision in the

act of incorporation in case of a special charter, or in the general law or in the articles of incorporation under a general law, no implied promise can be imputed to a corporation to pay for the services of a corporator or promoter before the corporation comes into existence. A contract made by promoters may be adopted by a corporation, expressly or impliedly, by exercising rights under it; but otherwise it is not binding upon such corporation. *Kelner* v. *Baxter*, *supra; Melhado* v. *Railway*, *supra; Railway* v. *Ketchum*, 27 Conn. 170; *Kerridge* v. *Hesse*, 9 Carr. & P. 200; *Munson* v. *Railway*, 103 N.Y. 58; *Morrison* v. *Mining Co.*, 52 Cal. 306; *Gent* v. *Ins. Co.*, 107 Ill. 652; *Railway* v. *Sage*, 65 Ill. 328; *Western, etc., Co.* v. *Cousley*, 72 Ill. 531; *Buffington* v. *Borden*, 80 Wis. 635; see also, *Railway* v. *Helensburgh*, 2 McQuean (H. of L.); same case, 2 Jur. N.S. 695; *Teft* v. *Bank*, 141 Pa. 550.

Now, when it is said that when a corporation accepts the benefit of a contract made by its promoters, it takes it cum onere, it is important to understand distinctly what is meant. There is, so far as this matter is concerned, a radical difference between a promise made on behalf of the future corporation in the contract itself, the benefits of which the corporation has accepted, and the promise in a previous contract to pay for services in procuring the latter to be made. This is well illustrated by the facts of the present case. Here a proposition was made on behalf of the company, by its promoters, that if a bonus should be subscribed and paid to it, it would build its road between certain points, and would carry coal at a certain stipulated rate.

By accepting the bonus, the company became bound to fulfill the stipulations of that contract. That was the burden which it took with the benefit of the agreement. But it also appears that one of the promoters promised the plaintiff, that if he would assist in procuring subscribers to the bonus, the company would pay him for his services. This was no part of the contract the benefits of which were taken by the defendant.

The benefits of a contract are the advantages which result to either party from a performance by the other; and in like manner its burdens are such as its terms impose. A more accurate manner of stating the nature of the plaintiff's demand is to say, that the defendant has accepted the benefit of the plaintiff's services and should pay for them. It is true, in one sense, that the company has had the benefit of plaintiff's services, and it is equally true that it would have had that benefit if the services had been rendered under an employment by the subscribers to the bonus; and yet in the latter case it could not be claimed that the company would be liable for such services, unless payment for them by the company were made one of the terms of the contract between the company and the subscribers.

In *Re Rotherham, etc., Company*, 50 Law Times Reports, New

Series, 219, in the opinion of one of the justices, this language is used: "It is said that Mr. Peace has an equity against the company, because the company had the benefit of his labor. What does that mean? If I order a coat and receive it, I get the benefit of the labor of the cloth manufacturer; but does any one dream that I am under any liability to him? It is a mere fallacy to say, that because a person gets the benefit of work done by somebody else, he is liable to pay the person who did the work."

There is more doubt as to the plaintiff's right to recover for his legal services in advising as to the articles of incorporation and in correcting and preparing this paper. Such services are usually necessary, and it would seem that the corporation should pay for them. Such payment is frequently provided for in the act of incorporation, or in the articles when the incorporation is effected under a general law. When such is the case, persons who take stock in the company are chargeable with notice that a liability for this purpose has already been created, and it is proper for the corporation to discharge it. But in the absence of such provision in the statute or in the articles, it may be unjust to shareholders to charge the corporation with liabilities of which they had no actual knowledge at the time they accepted the shares. We therefore hold, with some hesitation, that claims for the necessary expenses of the organization, under our statute, should not be excepted from the general rule applicable to contracts made before the corporation has come into legal existence.

Applying the rules we have announced to the case before us, it is apparent that the plaintiff has recovered, in part at least, for services for which the defendant was not bound to pay. He made his contract before the company had a legal existence as a corporation, with a single promoter; and it is a matter of no moment that the promoter was the general manager of the project and became the owner of the majority of the stock upon its organization. There were other stockholders. The law requires that there should be ten at least. Rev. Stats., art. 4099.

The evidence does not disclose that his contract with Anderson was actually known to any other person; nor do we see any other circumstance from which knowledge should necessarily be inferred. Since Anderson had no power to bind the future corporation, but could bind himself, the inference from his assisting Anderson would be that he was acting gratuitously, or that Anderson had agreed to pay him.

Anderson was interested in shifting his contract upon the company; and it may be doubted whether, although he became a director, notice to him could be deemed notice to the company. The Court of Civil Appeals find, however, that the company had notice.

Waiving the question of the right of the court to supplement the finding of the trial judge under such evidence, and the further ques-

tion whether there be any evidence to support this conclusion, it follows from what we have already said, that the question of the company's knowledge does not affect the case. The plaintiff's contract with Anderson, though made by the latter on behalf of the company, was not a lien, encumbrance, or burden upon the contract between the subscribers to the bonus and the defendant, and it incurred no liability on the former contract by accepting the benefit of the latter.

The evidence was sufficient to sustain a recovery by the plaintiff for the value of his services rendered after the corporation was created; but the court below failed to find separately the reasonable worth of such services. Therefore the entire judgment must be reversed.

We deem it proper to say, in conclusion, that if the opinion in the case of *McDonough* v. *Bank*, 34 Texas, 309, is to be construed as holding that merely by accepting the benefit of the plaintiff's labor, the defendant ratified and became bound under the promoter's contract, it does not meet our approval. Whether the contract in that case was one which the bank had the power to ratify, is to say the least a doubtful question; but it is one that does not concern us here, and upon which we express no opinion.

The judgments of the District Court and of the Court of Civil Appeals are reversed and the cause remanded.

Reversed and remanded.

CHAPTER III.

ISSUES OF STOCK AT A DISCOUNT OR FOR OVERVALUED PROPERTY.[1]

PELL'S CASE.

L.R. 5 Ch. 11. 1869.

THIS was an appeal from an order of the Master of the Rolls made in the winding-up of the Heyford Company, Limited. The case is reported, Law Rep. 8 Eq. 222. The company was registered in August, 1865. George Pell signed the memorandum of association as a subscriber for 1350 shares of £20 each.

In clause 86 of the articles of association a certain agreement was set forth which was thereby ratified and declared to be binding on the company, by which Pell agreed to sell to the company the good will and stock in trade of a certain business carried on by him, and it was agreed that as part of the consideration to be paid to Pell by the company, the company were to issue to Pell, or his nominees, 1500 shares of the nominal value of £20 each, which shares should be credited in the books of the company as fully paid up, and that Pell would accept the same in part payment of the purchase or consideration money for his interest in the premises sold to the company.

150 paid-up shares were accordingly allotted in the names of Pell's nominees, and 1350 in his own name.

On the 21st of December, 1866, the company was ordered to be wound up.

The books of the company shewed no payment for the shares standing in Pell's name, and no other shares were allotted to him except the shares mentioned in the articles.[2] Under these circumstances the Master of the Rolls held that Pell was liable as a contributory, but was entitled to be allowed the value of any property handed over by him to the company; and accordingly made an order placing Pell on the list of contributories, but directing an inquiry as to the value of the property handed over by him. From this decision Pell appealed.

[1] The cases in this chapter deal only with such issues when made by a corporation at its formation, or, at least, before its capital has been impaired through losses. Whether a corporation, the capital of which has been impaired by losses, may properly make such issues is considered, *infra*, in the Book on the Reorganization of Corporations.

[2] On the report of the case in L.R. 4 Eq. 222, it is stated: "The books of the company shewed no payment for the shares standing in Pell's name, except the handing over of the good-will and stock-in-trade under the agreement."

Sir G. M. Giffard, L.J. I agree with the Master of the Rolls that the shares issued by the company to Pell must be taken to have been issued in respect of their obligation under the agreement. But the Master of the Rolls directed an inquiry as to the value of the property handed over by him under the agreement, and declared the Appellant entitled to be allowed only the amount of that value. Now that agreement has not been impeached by any evidence or otherwise. The Court has, therefore, no grounds for going behind that agreement. I must, consequently, take it that in this case, as in *Drummond's Case*, Law Rep. 4 Ch. 772, the subscriber agreed to take 1350 shares, and that he paid for them in money's worth. I think, therefore, he must be struck off the list of contributories.

Note. — In *Drummond's Case*, L.R. 4 Ch. 772, Sir G. M. Giffard, L.J., said (p. 779): "If a man contracts to take shares he must pay for them, to use a homely phrase 'in meal or in malt;' he must either pay in money or in money's worth. If he pays in one or the other, that will be a satisfaction."

Pell's Case and *Drummond's Case* concerned companies formed under the Companies Act of 1862, prior to 1867. By the Companies Act of 1867, § 25, it was provided as follows: "Every share in any company shall be deemed and taken to have been issued and to be held subject to the payment of the whole amount thereof in cash, unless the same shall have been otherwise determined by a contract duly made in writing, and filed with the Registrar of Joint Stock Companies at or before the issue of such shares." This was a restrictive, not an enabling provision. Certain methods of payment which had theretofore been valid, were now invalid unless the provisions of this section were complied with. As to what amounted to a payment in cash, so that no contract under this provision was necessary, see *Spargo's Case*, L.R. 8 Ch. 407.

In *Anderson's Case*, L.R. 7 Ch. Div. 75, Thesiger, L.J., said (p. 112), with reference to this provision: "I think it may very fairly be said — at all events I do not dissent from that view — that under the word 'contract' is intended a contract binding in law, which of course imports a consideration, although we may not be able to go into the question of what was the value of the consideration."

OOREGUM GOLD MINING CO., LTD., *v.* ROPER.

[1892.] A.C. 125.

The Ooregum Gold Mining Company, Limited, was incorporated in October 1880 under the Joint-Stock Companies Acts 1862 to 1880. The statement contained in the memorandum of association with

reference to the capital of the company was as follows: — "The capital of the company is £125,000, divided into 125,000 shares of £1 each, and the shares of which the original or increased capital may consist may be divided into different classes and issued with such preference, privilege, guarantee, or condition as the company may direct." Forty thousand of the shares were allotted to the vendors to the company, the residue were issued to the public, and the full amount paid thereon. The operations of the company were not, in the first instance, successful, and a winding-up order was obtained. An application was subsequently made to the Court for an order to stay the winding-up, with a view to the introduction of fresh capital and a resumption of mining operations, and an order was made accordingly. In pursuance of this policy an extraordinary general meeting of the company was summoned in 1885, at which it was resolved that the capital should be increased by the issue of 120,000 preference shares of £1 each, to be credited in the capital and books of the company as having the sum of 15*s.* per share paid thereon, such preference shares carrying the right to a non-cumulative preference dividend up to 10 per cent. on the nominal amount of such preference capital out of the profits of the undertaking each year, and to equal participation (share per share) with the ordinary shares in such further profits as should remain for distribution each year after the payment of the above 10 per cent. preference dividend. The special resolution so passed was duly confirmed. At this time the market value of the ordinary shares was only 2*s.* 6*d.* per share.

Upwards of 100,000 of these preference shares were allotted, with 15*s.* credited as paid thereon. Prior to the actual allotment an agreement was entered into between the company, of the one part, and an agent or trustee for the several persons whose names were entered in the schedule thereto, of the other part, whereby, after reciting the agreement to issue the shares at a discount of 15*s.* per share, and that 1*s.* had been paid on allotment, it was agreed that the shares to be allotted should be held as shares on which 16*s.* per share had been paid, and should be subject and liable to further payment of 4*s.* per share, and no more, and the company thereby undertook to cause the agreement to be registered at the Joint-Stock Registration Office, pursuant to the Companies Act 1867, before the issue of the shares. The agreement was duly filed accordingly. The capital raised by means of the issue of the preference shares sufficed to discharge the obligations of the company, to extricate it from its difficulties, and to give it a new start. Gold to a considerable amount was shortly afterwards raised from the mines, and the company has since been prosperous, the market value of the ordinary shares having risen to about 40*s.*

In February 1889 the respondent, George Roper, purchased on the Stock Exchange and paid for ten fully paid-up ordinary shares

in the company. On the 15th of July following on behalf of himself and the other ordinary shareholders Roper brought this action against the company and Wallroth (as an original allottee of the preference shares and as representing the other original allottees) to have it declared that the issue by the company of the 120,000 preferred shares, at a discount of 15*s.* per share, was ultra vires, and to have the register rectified accordingly and other consequent relief granted. The statement of claim contained the allegation that the company had in 1889 issued debentures to the amount of £20,000, which were charged on all the property of the company, and which were then outstanding. It further alleged as follows: — "The defendant company had no power to issue the said preferred shares at a discount, and the entry of the preferred shares in the register book as fully paid-up should be rectified. The said preferred shares are now quoted on the Stock Exchange at a premium, and if the said entry is rectified the ordinary shares will benefit thereby, and the 15*s.* unpaid on the preferred shares will be available for paying off the said debentures as and when they fall due."

North, J., upon the authority of *In re Almada and Tirito Company*, 38 Ch.D. 415, without argument made an order declaring that the issue of the preferred shares of £1 each at a discount of 15*s.* per share was beyond the powers of the company, and that the said shares so far as the same were held by Wallroth or by original allottees represented by him were held subject to the liability of the holders to pay to the company in cash so much of the £1 per share as had not been paid on the same; and ordering that the company do rectify the register in accordance with the above declaration. This order was affirmed by the Court of Appeal without argument. Against these orders appeals were brought by the company and by Wallroth.

Lord Halsbury, L.C.: My Lords, the question in this case has been more or less in debate since 1883, when Chitty, J., decided that a company limited by shares was not prohibited by law from issuing its shares at a discount. That decision was overruled, though in a different case, by the Court of Appeal in 1888, and it has now come to your Lordships for final determination.

My Lords, the whole structure of a limited company owes its existence to the Act of Parliament, and it is to the Act of Parliament one must refer to see what are its powers, and within what limits it is free to act. Now, confining myself for the moment to the Act of 1862, it makes one of the conditions of the limitation of liability that the memorandum of association shall contain the amount of capital with which the company proposes to be registered, divided into shares of a *certain fixed amount.* It seems to me that the system thus created by which the shareholder's liability is to be limited by the amount unpaid upon his shares, renders it impossible for the company to depart from that requirement, and by any expedient to arrange

with their shareholders that they shall not be liable for the amount unpaid on the shares, although the amount of those shares has been, in accordance with the Act of Parliament, fixed at a certain sum of money. It is manifest that if the company could do so the provision in question would operate nothing.

I observe in the argument it has been sought to draw a distinction between the nominal capital and the capital which is assumed to be the real capital. I can find no authority for such a distinction. The capital is fixed and certain, and every creditor of the company is entitled to look to that capital as his security.

It may be that such limitations on the power of a company to manage its own affairs may occasionally be inconvenient, and prevent its obtaining money for the purposes of its trading on terms so favourable as it could do if it were more free to act. But, speaking for myself, I recognise the wisdom of enforcing on a company the disclosure of what its real capital is, and not permitting a statement of its affairs to be such as may mislead and deceive those who are either about to become its shareholders or about to give it credit.

I think, with FRY, L.J., in the *Almada and Tirito Company's Case*, 38 Ch.D. 415, that the question which your Lordships have to solve is one which may be answered by reference to an inquiry: What is the nature of an agreement to take a share in a limited company? and that that question may be answered by saying, that it is an agreement to become liable to pay to the company the amount for which the share has been created. That agreement is one which the company itself has no authority to alter or qualify, and I am therefore of opinion that, treating the question as unaffected by the Act of 1867, the company were prohibited by law, upon the principle laid down in *Ashbury Company* v. *Riche*, Law Rep. 7 H.L. 653, from doing that which is compendiously described as issuing shares at a discount.

The question remains whether § 25 of the Act of 1867 has made any difference in the matter now under discussion. That section prescribes that every share in any company shall be deemed and taken to have been issued and to be held *subject to the payment* of the whole amount thereof *in cash*, unless the same shall have been otherwise determined by contract duly made in writing, and filed with the Registrar of Joint-Stock Companies at or before the issue of such shares. Two things are manifest in this provision. The share is to be held subject *to payment*, and the payment is to be *in cash*. The amount is to be paid and the whole amount to be paid *in cash*, and to me it appears, looking at the latter part of the section, whereby a contract made and filed may qualify and cut down the form of payment, and that it may be in goods or in value received in some form, instead of in cash, it must nevertheless be payment. I regret that the words *in cash* have received a judicial exposition which allows

payment otherwise than in cash, and I hold myself free, if the question should ever come before your Lordships, to consider the propriety of that decision. But for my present purpose it is enough to say that there is nothing in the section which justifies the notion that that which the statute required to be paid in cash, subject to qualification of a mode of payment, should not be paid at all.

LORD WATSON: My Lords, can a company limited by shares, formed and registered under the Act of 1862, issue its shares as fully paid up, for a money consideration less than their nominal value? That was the only question argued in these appeals. It has been answered in the negative by both Courts below, without hearing argument, upon the authority of the *Almada and Tirito Company's Case*, 38 Ch.D. 415, decided by the Court of Appeal in 1888. The limitation of such a company's liability is the creature of statute, and the question lies within a narrow compass, depending on the construction of one or two clauses in the Companies Acts of 1862 and 1867.

The Act of 1862 (§ 8 (5)) requires that, in the case of a company limited by shares, the memorandum of association shall contain the amount of the capital with which it proposes to be registered, divided into shares of a certain fixed amount. The statutory limitation which it imposes upon the liability of individual shareholders is contained in the enactment (§ 38 (4)), that "no contribution shall be required from any member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as a present or past member." In my opinion, these enactments read together indicate the intention of the Legislature that every member who takes shares from the company in return for cash shall either pay or become liable to contribute their full nominal value. The "amount, if any, unpaid," obviously refers to the "fixed amount" of the shares into which the capital is divided, as set forth in the memorandum, and not to any lesser amount which may be agreed upon between the company and its shareholders; and the statutory liability of each shareholder is for the difference between the amount fixed by the memorandum and the sum which has actually been paid upon his shares. Consequently, if shares are issued against money, it appears to me that any payment to the company less than the nominal amount of the share must, by force of the statute, and notwithstanding any agreement to the contrary, be treated as a payment to account, the member remaining liable to contribute the balance, when duly called for.

A company is free to contract with an applicant for its shares; and when he pays in cash the nominal amount of the shares allotted to him, the company may at once return the money in satisfaction of its legal indebtedness for goods supplied or services rendered by him. That circuitous process is not essential. It has been decided that, under the Act of 1862, shares may be lawfully issued as fully

paid up, for considerations which the company has agreed to accept as representing in money's worth the nominal value of the shares. I do not think any other decision could have been given in the case of a genuine transaction of that nature where the consideration was the substantial equivalent of full payment of the shares in cash. The possible objection to such an arrangement is that the company may over-estimate the value of the consideration, and, therefore, receive less than nominal value for its shares. The Court would doubtless refuse effect to a colourable transaction, entered into for the purpose or with the obvious result of enabling the company to issue its shares at a discount; but it has been ruled that, so long as the company honestly regards the consideration given as fairly representing the nominal value of the shares in cash, its estimate ought not to be critically examined. That state of the law is certainly calculated to induce companies who are in want of money, and whose shares are unsaleable except at a discount, to pay extravagant prices for goods or work to persons who are willing to take payment in shares. The rule is capable of being abused, and I have little doubt that it has been liberally construed in practice.

The Companies Act of 1867 contains one clause only which can effect the present question. Sect. 25 enacts that "every share in any company shall be deemed and taken to have been issued and to be held subject to the payment of the whole amount thereof in cash, unless the same shall have been otherwise determined by a contract duly made in writing, and filed with the Registrar of Joint-Stock Companies at or before the issue of such shares."

It was argued that § 25 recognises power in the company to accept a partial payment as a cash payment in full, provided there be a contract to that effect duly executed and filed with the registrar. I am unable so to construe the clause. I do not think its object was to give companies new powers in relation to the issue of their shares, but to regulate the statutory powers already possessed by them in regard to the acceptance of other than cash payments as part of their capital. The expression "unless the same shall have been otherwise determined" does not, in my opinion, imply that part payment may be accepted as payment in full. It refers to contracts so far as then lawful, by which a company might agree to accept considerations other than cash. In all such cases, the clause provides that the contract, if not duly filed with the registrar, shall be of no effect, and that the shareholder shall remain liable for the value of his shares in money. The obvious purpose of the enactment is to enable persons dealing with the company to judge for themselves what may be the value of the consideration given as representing capital.

It is admitted that the appellants acted in good faith, and that the arrangement made with them would, even if carried out to the letter, have been of solid advantage to the company. But they accepted

shares of the nominal value of 20*s*. as fully paid up, in the knowledge that only 5*s*. per share had been paid; and they cannot, therefore, benefit by the principle recognised by this House in *Waterhouse* v. *Jamieson*, Law Rep. 2 H.L., Sc. 29, and *Burkinshaw* v. *Nicolls*, 3 App. Cas. 1004.

It was urged at the bar that the appellants could have secured by other means all the advantages which were stipulated in their contract with the company; that, instead of 20*s*. shares, the company could have issued 5*s*. shares fully paid, bearing a preferential dividend of 40 per cent., and participating in the remaining profits equally with its ordinary 20*s*. shares; or that the appellants might themselves have bought the goods purchased with their contributions, and received in exchange 20*s*. shares fully paid up. I see no reason to doubt that the first of these courses might have been successfully adopted; but I am not certain that the second would have been a legitimate proceeding, seeing that it might have involved acceptance by the company of goods in lieu of cash, at an estimated price of no less than four times their actual cost. It is needless, however, to consider what the parties might have done, if that which they did is not of legal effect.

In my opinion, therefore, the register of the company is erroneous, in so far as it bears that these additional shares have been fully paid up; and the order appealed from, which merely provides for its correction in that respect, ought to be affirmed.

Lord Herschell: My Lords, this case raises the important question whether a company incorporated with limited liability can issue its shares at a discount.

The question whether there was power to issue the shares depends mainly upon the construction of the 8th and 38th sections of the Companies Act 1862, though the 25th section of the Companies Act 1867 has also a material bearing upon it. By the 8th section of the Act of 1862 it is enacted that in the case of a company limited by shares the memorandum of association shall contain "the amount of capital with which the company proposes to be registered divided into shares of a certain fixed amount." The 38th section of the same statute provides that in the event of a company formed under the Act being wound up, every present and past member should be liable to contribute to the assets of the company to an amount sufficient for payment of the debts and liabilities of the company, and the costs of the winding-up, and for the payment of such sums as may be required for the adjustment of the rights of the contributories amongst themselves, with (amongst others) this qualification, that in the case of a company limited by shares, no contribution should be required from any member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as a present or past member.

It is contended that these two enactments taken together pre-

clude a company from issuing shares as fully paid up in respect of the payment of a sum less than the nominal amount of the share — that is to say, that a person taking a share on those terms, if he remains a shareholder, is liable to pay the difference between the amount he has already paid and the nominal value of the share. If it had been determined that under the Companies Act a shareholder was in all cases liable to pay the whole of the nominal value of a share in cash, I should have had less difficulty in adhering to the judgment of the Court below. But the contrary has been determined. And not only may a share be allotted as fully paid up in respect of property, goods, or services received by the company, but the Courts will not inquire into the adequacy of the consideration, and certainly have not required it to be proved that the consideration given was equivalent in cash value to the nominal amount of the share. The transactions which have taken place on this view of the law have been so numerous, and have extended over so long a period of years, that I doubt if it would have been possible for your Lordships to adopt a different view now, even if the legislature had not intervened. But I think that the legislature has distinctly recognised and given its sanction to these decisions.

The 25th section of the Companies Act 1867 provides that every share in any company shall be deemed and taken to have been issued and to be held subject to the payment of the whole amount thereof in cash, unless the same shall have been otherwise determined by contract duly made in writing, and filed with the Registrar of Joint-Stock Companies at or before the issue of such shares. I quite agree that this enactment does not purport to render valid an issue of shares in respect of something other than full cash payment, in case it would have been invalid under the Act of 1862. But it seems to me distinctly to recognise the validity of such a transaction, imposing only the condition that the contract determining that payment is not to be made in cash shall be in writing and duly filed. The object of this is obvious. It is to enable any creditor, by reference to the documents at the office of the Registrar of Joint-Stock Companies, to ascertain how much of the liability on the shares which does not remain undischarged has been discharged by cash payment, and how much in some other way. A creditor has not the right to assume that so much of the amount of the share as is no longer liable to be called up has found its way in the shape of cash into the hands of the company. But he has placed at his disposal the means of full information on the subject.

Having regard to the considerations to which I have called attention, and notably to the provisions of the Act of 1867, I do not feel so much impressed as some of your Lordships by the mischiefs which it is contended would result from the decision that shares might be issued as fully paid up in consideration of a payment less in amount

than their nominal cash value, and I can conceive many cases in which such a course would be advantageous both to shareholders and creditors. But the matter must, after all, be determined by an examination of the language of the Act of 1862, bearing in mind, of course, the decisions upon it, and the subsequent legislation, which, as I think, sanctioned and acted on those decisions.

I cannot myself place any great weight on the requirement of § 8, that the amount of capital with which the company proposes to be registered is to be divided into shares "of a certain fixed amount." The provision was, of course, necessary in introducing a scheme of limited liability. But it does not, of itself, determine anything as to the extent of liability. Had it stood alone, the shareholders would have been liable, on general principles, to the extent necessary to discharge all the obligations of the industrial partnership. The limitation of liability arises from the provision of § 38, that in case the company is wound up an individual shall only be liable "to the amount, if any, unpaid on the shares in respect of which he is liable as a present or past member." This must be regarded as by implication enacting that he shall be liable to that extent. What, then, is the meaning of the "amount unpaid" on the shares? If it had been the law that taking shares in a limited liability company necessarily involved the payment in cash of the nominal amount of the share, the answer would have been free from difficulty. The words "the amount unpaid" would have been taken in their ordinary sense as meaning so much as has not been paid in cash. But it is impossible now to adopt that interpretation as applicable to every case.

The Acts of 1862 and 1867 must be read together. And the latter statute prescribes that a share shall be deemed to be held subject to the payment of the whole amount thereof in cash, unless "the same shall have been otherwise determined" by a filed contract. What is "the same"? Clearly, as it appears to me, that the share is held subject to the payment of the whole amount in cash. When, then, it has been lawfully "otherwise determined," it appears to me impossible that the words "the amount unpaid" can have their ordinary meaning. They must, at least, be interpreted as meaning "unpaid, or not otherwise satisfied, in accordance with the provisions of a filed contract." And once this conclusion is arrived at, I do not think there would be any insuperable difficulty in including within them the case where, in consideration of a certain payment, the liability had been by a filed contract entirely discharged.

At the same time, I am quite sensible of the force of the argument that in the 25th section of the Act of 1867 the emphatic words are payment "*in cash*," implying that there must be payment in some form, even though it is not to be made in cash. And whilst goods or services given or taken in lieu of payment in cash may be regarded

as in a sense payment, it is difficult to say that payment of a portion of a sum is payment of the whole. Although, therefore, my mind has not been free from doubt, I am not prepared to differ from the Court below, and from those of your Lordships who entertain that view, in thinking that a company cannot issue its shares at a discount so as to exonerate those taking the shares from the liability, in case the company be wound up, to pay the amount not already paid on the shares.

But the question before your Lordships does not arise in the case of a winding-up. The interest of the creditors is not in issue. The action is brought by a shareholder avowedly for the purpose of benefiting the holders of the ordinary shares at the expense of those who are possessed of the preference shares, which were taken on the express condition that their holders should not be required to pay more than 5*s.* per share. To accede simpliciter to the prayer of the plaintiff would, as it seems to me, be to sanction a violation by the company of a solemn agreement entered into between them and those who took the shares. I should have thought it was wrong to do this, except in so far as the contract provides for that which has been otherwise provided for by the legislature. In so far as the obligations arising under the contract do not involve a contravention of any enactment of the legislature, I see no reason why they should not be given effect to. The point was not argued at the bar in the present case, but I will give my reasons for the opinion I have expressed. Except when the legislature has expressly or by implication forbidden any act to be done by a company, their rights must be governed by the ordinary principles of law, and they are free to make, as between them and their shareholders, such contracts as they please. They may enter into any undertaking with those who are invited to become shareholders as to the terms on which the shares shall be taken, and as to the rights of the respective shareholders inter se. What they cannot do is to exclude the liability, in case the company is wound up, to contribute to the extent unpaid on the shares for the benefit of the creditors. But what is to prevent the company agreeing that, except in so far as the legislature has imposed the liability, they will not enforce any? Supposing the agreement had been in terms that the company would not enforce the payment of more than 5*s.* per share, except in the case of a winding-up, and then only to satisfy the claims of creditors and the costs of the winding-up, would there have been anything illegal in such an agreement? I fail to see anything in the Companies Acts which would render such an agreement invalid. And taking the contract between the company and the shareholders, and the enactment together, is not this, in effect, what has been done? I am, of course, assuming that to issue shares on such terms would be within the memorandum of association. There can be no doubt of that in the present case. It is pro-

vided that the original or increased capital may be issued with "such preference, privilege, guarantee, or condition" as the company may direct.

Whilst, then, I think it ought to be declared that the agreement between the company and those to whom the preference shares were allotted was ineffectual to absolve them from the liability prescribed by the 38th section of the Act of 1862, I should have thought, had the point been insisted upon, that it ought also to be declared that the company are not entitled to call upon such shareholders for any further payment beyond that agreed upon, except in the case of a winding-up, and then only so far as necessary for the discharge of the obligations of the company and the costs of the winding-up.

Lord Macnaghten: My Lords, your Lordships are called upon to determine whether it is or is not competent for a company limited by shares to issue shares at a discount so as to relieve persons taking shares so issued from liability to pay up their amount in full. It was suggested that different considerations might apply to shares in the capital with which a company is originally registered and shares in additional capital created afterwards. But it seems to me to be perfectly clear that, for the present purpose, no distinction can be drawn between one portion of the capital of a company limited by shares and another.

The question turns upon the construction of the Companies Act 1862. The provisions of the Act are, I think, plain enough if one bears in mind the condition of things which existed before the principle of limited liability was introduced in 1855. Before that time there was no way known to the law by which persons trading in partnership could restrict their liability. They were liable to the uttermost farthing. At last the legislature intervened and authorised persons who proposed to trade in partnership to form themselves into a registered company with a declared capital and shares of a fixed amount, and then limited the liability of the partners as members of the company to the amount unpaid upon their shares.

But all this legislation proceeds on the footing of recognising and maintaining the liability of the individual members to the company until the prescribed limit is reached. The memorandum of association of a company limited by shares must contain "the amount of capital with which the company proposes to be registered divided into shares of a certain fixed amount." It must also contain "a declaration that the liability of the members is limited." Neither the liability nor the limitation is defined in the memorandum itself. And so the declaration carries you back to the earlier part of the section, where you are told what is meant by "a company limited by shares." It is a company "formed on the principle of having the liability of its members limited to the amount unpaid upon their shares." That must mean that the liability of a member continues

so long as anything remains unpaid upon his shares. Nothing but payment, and payment in full, can put an end to the liability.

Plainer still and more explicit is the section headed "Liability of members." It begins by declaring that, in the event of a company formed under the Act being wound up, the measure of the liability of every present and past member is the amount required to satisfy all claims of creditors, to pay all the expenses of liquidation, and to adjust the claims of members inter se. Then come certain qualifications to which that liability is subject. One is, that in the case of a company limited by shares no contribution shall be required from any member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as a present or past member.

To sum the matter up, I cannot, I think, do better than adopt the language Mr. Buckley has used in speaking of the Limited Liability Acts. "The dominant and cardinal principle of these Acts," he says, "is that the investor shall purchase immunity from liability beyond a certain limit, on the terms that there shall be and remain a liability up to that limit." Whether this liability is one of "the conditions of the memorandum," within the meaning of that expression in the Act of 1862, as Lord SELBORNE seems to have thought (*Dent's Case*, Law Rep. 8 Ch. 768), or a condition attached by the Act to a company limited by shares and of the essence of such a company, though it may not be found contained within the four corners of the memorandum, is a matter of little or no importance. In either view of the case it is plain that the condition is one which cannot be dispensed with by anything in the articles of association, or by any resolution of the company, or by any contract between the company and outsiders who have been invited to become members of the company and who do come in on the faith of such a contract.

If this conclusion be correct, there is, I think, an end of the question, and the arguments urged on behalf of the appellants may be disposed of very briefly. . . .

Lastly, it was said that if it be the case that, in companies limited by shares, members are liable to pay up in full the amount, if any, unpaid upon their shares, still the liability is one that may be easily evaded. And it was pointed out that, in the present case, if only a different method had been adopted, a result practically the same might have been attained, and then the transaction would have been unimpeachable. Whether that is a good reason for permitting the requirements of an Act of Parliament to be contravened may, perhaps, be doubted.

But I desire to protest against some of the propositions which were advanced in connection with this part of the argument. It was said that if a company limited by shares owes its bankers £1000, and its shares are at 50 per cent. discount, fully paid shares of £2000 nominal value may be given in discharge of the debt. It was said that a

company limited by shares may issue fully paid shares at their market price at the time, however much they may have become depreciated, in exchange for goods having a recognised market value. Speaking for myself, I am not prepared to assent to either of those propositions without further argument. I am inclined to agree with the view expressed by COTTON, L.J., though it is not necessary to decide the point. It seems to me that all that has been determined so far is that the Court will decline to rip up a transaction not impeached as dishonest, and not proved to be such, merely because the company may have paid an extravagant price for their property.

In the present case, I regret that I am compelled to say that in my opinion the transaction cannot stand. The course which the directors took probably saved the company. All parties concerned acted in a perfectly open and honest manner. But it seems to me that the requirements of the Companies Act 1862 have been contravened, and, therefore, I think that the appeal must be dismissed.

NOTE. — In *Welton* v. *Saffery*, [1897] A.C. 299, it was held that the holders of shares issued at a discount or by way of bonus, although this was authorised by the articles of association, were subject to liability, in a winding-up, to calls for the amounts unpaid on their shares for the adjustment of the rights of the shareholders *inter se*, as well as for the payment of the company's debts and the costs of winding-up. Lord HERSCHELL dissented.

In Re WRAGG, LIMITED.

[1897.] 1 Ch. 796.

THIS was a summons taken out by the official receiver, as the liquidator in the winding-up of the above-named company, in substance for a declaration that certain shares in that company held by Messrs. E. J. Wragg & J. B. Martin and registered in their names as fully paid up were not fully paid up, and for an order that Messrs. Wragg & Martin should forthwith pay the amounts unpaid thereon.

For many years prior to 1894 Messrs. Wragg & Martin carried on business together as omnibus and coach proprietors, livery-stable keepers and job-masters in Whitechapel, and elsewhere in London; and they were the owners of certain freehold and leasehold property, and a considerable number of horses and carriages, and a quantity of harness, stock-in-trade, plant and effects.

In 1894 they determined to convert their business into a private limited company, and with that intent they formed such a company to buy the goodwill, stock-in-trade, and property of their business at a price which they fixed at 46,300*l.*, to be payable in cash, debentures, and fully paid-up shares.

Of this 46,300*l.*, 27,300*l.* was, in the agreement with the company, placed as the value of the stock in trade. It appeared, however, that this same property was placed on the company's books, pursuant to a valuation by the vendors made at or about the time of the transfer, at 15,375*l.* The official liquidator claimed that the shares issued to the vendors must be regarded as unpaid to the extent of the difference between the two sums.[1]

The court considered how far it could examine into the value of property received by the company at a figure, in consideration of the issue of shares declared to be full paid.

LINDLEY, L.J. That shares cannot be issued at a discount was finally settled in the case of the *Ooregum Gold Mining Co. of India* v. *Roper*, [1892] A.C. 125, the judgments in which are strongly relied upon by the appellant in this case. It has, however, never yet been decided that a limited company cannot buy property or pay for services at any price it thinks proper, and pay for them in fully paid-up shares. Provided a limited company does so honestly and not colourably, and provided that it has not been so imposed upon as to be entitled to be relieved from its bargain, it appears to be settled by *Pell's Case*, L.R. 8 Eq. 222; 5 Ch. 11, and the others to which I have referred, of which *Anderson's Case*, 7 Ch.D. 75, is the most striking, that agreements by limited companies to pay for property or services in paid-up shares are valid and binding on the companies and their creditors. The legislature in 1867 appears to me to have distinctly recognised such to be the law, but to have required in order to make such agreements binding that they shall be registered before the shares are issued.

There is certainly no decision yet which is opposed to the above statement of the law. The observations in *In re Addlestone Linoleum Co.*, 37 Ch.D. 191, *In re Almada and Tirito Co.*, 38 Ch.D. 415, *Lee* v. *Neuchatel Asphalte Co.*, 41 Ch.D. 1, and *Ooregum Gold Mining Co. of India* v. *Roper*, [1892] A.C. 125, relied upon by the appellant in this case, fall far short of deciding that the value of the property or services paid for in shares can be inquired into or is material in any case in which the sale is not impeached. These and other cases decided upon the Act of 1867 shew (1) that since that Act, as before, shares must be paid for in money or money's worth; (2) that since that Act, as before, they may be paid for in money's worth; (3) that since the Act payment in money's worth can only be effectually made pursuant to a properly registered contract; (4) that, even if there is such a contract, shares cannot be issued at a discount; (5) that if a company owes a person 100*l.*, the company cannot by paying him 200*l.* in shares of that nominal amount discharge him, even by a registered contract, from his obligation as a shareholder to pay up

[1] This statement of facts is greatly condensed, and it omits several details which, it is believed, have no bearing on the question of law involved.

the other 100*l.* in respect of those shares. That would be issuing shares at a discount. The difference between such a transaction and paying for property or services in shares at a price put upon them by a vendor and agreed to by the company may not always be very apparent in practice. But the two transactions are essentially different, and whilst the one is ultra vires the other is intra vires. It is not law that persons cannot sell property to a limited company for fully paid-up shares and make a profit by the transaction. We must not allow ourselves to be misled by talking of value. The value paid to the company is measured by the price at which the company agrees to buy what it thinks it worth its while to acquire. Whilst the transaction is unimpeached, this is the only value to be considered.

A. L. SMITH, L.J. It is now well settled law that for a shareholder in a company limited by shares to have fully paid-up shares, and therefore not to be liable for calls in a winding-up of the company, he must shew that he has fully paid up to the face value of the shares, either in cash or in value received by the company in some form; or partly in cash and partly in value received by the company in some form; and if the payment other than in cash be relied on, this can only be so if there be a "contract duly made" in writing, and filed with the Registrar of Joint-Stock Companies, at or before the issue of the shares, pursuant to § 25 of the Companies Act, 1867. The House of Lords has definitely settled this point in the case of the *Ooregum Gold Mining Co. of India* v. *Roper*, [1892] A.C. 125.

Partial payment is not sufficient; but shares may be lawfully issued as fully paid up for considerations which the company have agreed to accept as representing in money's worth the nominal value of the shares: per Lord WATSON in the *Ooregum Case*, [1892] A.C. 136.

It is not suggested that the contract of January 10, 1894, is not an honest bargain, or that its consideration is colourable or illusory.

Now, is a liquidator entitled to go into the adequacy of the consideration, and to shew, if he can, that the consideration for the contract was inadequate, unless it appears so upon the transaction itself; or, if not, if he desires to do so, must he not impeach the contract itself?

If there be no consideration at all for the shares, and it be shewn, as in the case of *In re Eddystone Marine Insurance Co.*, [1893] 3 Ch. 9, that the words inserted in the registered contract, "in consideration of services," were placed there as a mere blind, that will suffice.

Again, if in a registered contract a money value less than the face value of the share be placed upon the consideration which the company had agreed to accept as representing in money's worth the nominal value of the share, that share, I should think, would not be fully paid up; for instance, as was put in argument, a contract to supply to a limited company 100 tons of coal, valued at 10*s.* per ton, as a consideration for 100 1*l.* shares in the company — i.e., a

value of 50*l.* worth of coal for 100 1*l.* shares — these shares would not be, I think, fully paid up.

There would be no necessity in such a case for impeaching the agreement, for that the shares were not fully paid up in money or money's worth would be apparent upon its face. COTTON, L.J., in *In re Almada and Tirito Co.*, 38 Ch.D. 421, points to such a case as this, though he did not decide it.

If, however, the consideration which the company has agreed to accept as representing in money's worth the nominal value of the shares be a consideration not clearly colourable nor illusory, then, in my judgment, the adequacy of the consideration cannot be impeached by a liquidator unless the contract can also be impeached; and I take it to be the law that it is not open to a liquidator, unless he is able to impeach the agreement, to go into the adequacy of the consideration to shew that the company have agreed to give an excessive value for what they have purchased.

RIGBY, L.J. I am not prepared to say that in no cases can the consideration in kind given for paid-up shares be inquired into, even although there may be nothing on the face of the contract to shew the insufficiency of the consideration; but I abstain from attempting to define what the cases are. I think it sufficient to say that in my judgment the opinions of the noble and learned Lords in the *Ooregum Case*, [1892] A.C. 125, sufficiently indicate that such cases may arise.

HONG KONG & CHINA GAS CO., LTD., *v.* GLEN.

[1914.] 1 Ch. 527.

THE Hong Kong and China Gas Company, Limited, was incorporated under the Joint-Stock Companies Acts, 1856, 1857, and 1858, in June, 1862, with a capital of 35,000*l.* divided into 3500 shares of 10*l.* each. The objects of the company were (amongst others) to manufacture, supply, and sell gas in the city of Victoria, Hong Kong, and other cities and places in China; to carry on the business of a gas company in those cities and places or any of them; to make and sell coke and other products; and to obtain charters, grants, and concessions from Her then Majesty's Imperial or Colonial Government, the Governor of Hong Kong, the Government of China, and other governments and authorities, to hold lands, and exercise the rights and powers of a body corporate or public company. Clause 5 of the articles of association provided that "no shares shall be issued at a discount unless with the authority of a special general meeting of shareholders duly convened for the purpose." By clause 24 the company was empowered to increase its

capital. By clause 53 the directors of the company were specially authorized to make and enter into a contract (a copy of which was scheduled to the articles) with William Glen and Thomas Glen.

The contract referred to in clause 53 was contained in certain articles of agreement which were dated July 14, 1862, and were made between William Glen of the first part, Thomas Glen of the second part, and the company of the third part. By that agreement, after recitals which shewed that William Glen had obtained a concession for supplying the city of Victoria, Hong Kong, with gas, that this concession had been transferred to Thomas Glen, and that the latter was prepared to sell it to the company, it was agreed (articles 1, 2, 3, and 4) that the concession should be effectually sold and transferred to the company, who should be free from any competition by the vendors; (articles 5 and 6) that in the event of either of the vendors acquiring any like concessions for any other place or places in China, they would not dispose thereof to any other party on any terms without first giving the company an ample opportunity of acquiring them upon the same terms; (article 7) that the company would within three months allot to Thomas Glen or his nominees 400 shares of 10*l.* each of the company's capital (not exceeding 20,000*l.*) and would provide 4000*l.* to be immediately applied in paying up the 400 shares in full.

Article 8 of the agreement was as follows:

"If and whenever the amount of the company's paid up capital shall be increased above the sum of 20,000*l.*, the company will allot to the said Thomas Glen, his executors, administrators or assigns, such further number of shares as shall be equal to one-fifth part of the increased capital, so from time to time actually paid up beyond the said sum of 20,000*l.*, and will pay to him, or them, or to the said Henry Parkinson Sharp and William Matthew Mills Whitehouse, as the nominees of him or them, a sum equal to the nominal amount of the shares so allotted to him or them, which sum or sums so paid shall from time to time be immediately applied in paying up in full the shares so allotted."

Articles 9 and 10 were merely ancillary to article 8.

Issues of stock were made, in accordance with this agreement, to Thomas Glen during his lifetime upon each increase of the company's stock. He died in 1900 and the present action was brought by the company against his executors for (1.) a declaration that the provisions contained in clauses 8, 9, and 10 of the articles of agreement were ultra vires the plaintiff company and invalid and void; and, alternatively, (2.) a declaration that, according to the true construction of the said articles of agreement, the provisions of clauses 8, 9, and 10 thereof ceased to operate after the issued capital of the company amounted to 50,000*l.*; and, in the further alternative, that any further shares to be allotted, on any future increase

of the company's capital, to the defendants or their nominees, in pursuance of the said articles of agreement, would, notwithstanding anything therein contained, be held by the nominees subject to the liability to pay the full nominal amount thereof in cash to the company, without any liability on the company to provide such cash or any part thereof.

SARGENT, J. I should premise that, although the incorporation of the company took place under the Act of 1856 and its amending Acts, and the language of the material provisions of the Act of 1856 differs slightly from that of the corresponding provisions of the Act of 1862, no material distinction for the present purpose has been pointed out between the meaning and effect of the two sets of provisions. It was practically conceded on both sides that the case of *Ooregum Gold Mining Co. of India* v. *Roper*, [1892] A.C. 125, and the other like decisions under the Act of 1862 apply equally to companies incorporated under the Act of 1856. And, indeed, the point is to some extent at least governed by authority: see *In re Weymouth and Channel Islands Steam Packet Co.*, [1891] 1 Ch. 66.

Next, the precise meaning and effect of the language of article 8 should be examined. This does not in terms provide that the shares should be issued at a discount or as fully paid up, and Mr. Gore-Browne uttered a warning against the use of catchwords in deciding this case. When, however, the clause is carefully examined, I cannot think that it tends less to contravene the statutory provisions as to the capital of companies than if it were a clause providing in terms for the issue of fully-paid shares. For, while the first part of the article contains an obligation to allot to Thomas Glen or his nominees one-fifth of all increased share capital, the second part of the article provides that, contemporaneously with such allotment, the company shall furnish cash equal to the full nominal value of the shares, and earmarks and dedicates that cash, so that it has immediately to return to the company's coffers for the purpose of paying up the very shares in full. It is impossible, in my view, to hold that the second part of article 8 does not amount to a contract for the contemporaneous absolution and discharge of the allottee from his prima facie statutory liability to provide the nominal value of his shares in money. But it is, of course, clear that a shareholder may effectually contract to discharge his liability on his shares by (inter alia) the transfer of property in lieu of the payment of cash, and that it is not essential that for this purpose the real value of the property transferred should be ascertained as being, or should be in fact, the full equivalent of the cash liability: *In re Wragg, Ltd.*, [1897] 1 Ch. 796. And accordingly it is argued, and this is the real pinch of the case, that the transfer of the concession, though made once and for all in 1862, was a sufficient equivalent in kind, not only for the discharge of the liability on the first 400 shares to be issued

to the concessionaire, but also for the discharge of the liability on a fifth of any increased capital that might at any future time be issued to the concessionaire by the company.

This argument, however, seems to me to go far beyond the decision in *In re Wragg, Ltd.*, [1897] 1 Ch. 796, and, indeed, to be in conflict with the views expressed both in that case and in the numerous cases there cited and examined, particularly *In re Almada and Tirito Co.*, 38 Ch.D. 415, 423, and the *Ooregum Case*, [1892] A.C. 125. These cases clearly shew that although a value put on purchased property by the contract, and not fixed dishonestly or colourably, would be accepted as conclusive for this purpose while the contract still stands, yet the contrary would be the case where the contract shews on its face that the property is not an equivalent for the amount of the capital which it is proposed to exempt from liability. For instance, if shares were contracted to be issued as paid up to the extent of 20,000*l.*, as against property which might be shewn outside the contract to be worth only 15,000*l.*, the arrangement would probably hold water as in *In re Wragg, Ltd.*, [1897] 1 Ch.D. 796, itself, where the discrepancy was one between a total of 35,000*l.* and a total of 46,000*l.* But, if the agreement were that the property to be purchased should be valued, and that against this property shares should be issued as fully paid to an extent exceeding the amount of the valuation by one-third, the arrangement would, in my judgment, be bad as to this excess of one-third. It would to this extent be apparent on the face of the contract that the attempted discharge of a part of the liability was illusory.

Now, in the present case the liability to be discharged on one-fifth of all future increases of capital obviously and necessarily has no connection with or relation to the value of the concession. The case is far stronger in this respect than if article 8 related only to share capital issued for the purpose of exploiting the concession in question. For it applies to the whole increased capital of the company, whatever the purpose for which it may be required. Indeed, the absurdity becomes specially obvious if the event is considered of a gas concession for any other place in China being transferred by the Glens to the company. In that case the company would, on the face of the agreement, have to pay the Glens the full value of the new concession, for the company are only to have the first refusal, and are not to be entitled to any better terms than any other purchaser. And yet after paying the full price they would still be bound, in respect of any share capital raised to complete the purchase, to issue a further 25 per cent. to the Glens, and pay up or credit as paid up the whole of this 25 per cent. in full.

It is true that an individual may contract to pay for property on any terms, and may find it convenient and choose to pay a price which shall be little or almost nothing in any ordinary event, but

shall be increased tenfold or a hundredfold in certain improbable events altogether unconnected with any increase in the value of the property purchased. But I do not see how a limited company can speculate in this way consistently with the principles laid down in the cases to which I have referred. As I understand the legislation in question, as interpreted by the cases, the liability of a shareholder may be discharged either by the meal of cash or by the malt of property, services, or the like; but this discharge will not take place if it is apparent that the malt bears no relation to the meal, and cannot therefore be estimated as being an equivalent for it. Can it be held here that the definite quantity of malt represented once and for all by the transfer of the concession is to be taken as the equivalent for ever of the obligation to render at any future time or times a wholly indefinite and unlimited quantity of meal? It seems to me that this question must be answered in the negative, and, indeed, that such a clause as article 8 could hardly have been introduced into the agreement of 1862 had the law on the subject been as fully ascertained at that date as it has since been.

[The court held that the agreement was bad only in so far as it provided that the shares should be issued without payment, and that the company was under the obligation to allot to the representatives of Glen one-fifth of the share capital from time to time issued.]

NOTE. — *Famatina Development Corporation, Ltd.*, v. *Bury*, [1910] A.C. 439. A company issued obligations by the terms of which it was obliged to pay specified sums, if there should be net profits available for that purpose. The question was whether it could issue paid-up shares to satisfy these obligations. The court held that the company could not lawfully make this charge on future net profits a charge on capital and a present debt, and then issue paid-up shares in satisfaction of the debt so created.

SCOVILL *v.* THAYER.

105 U.S. 143. 1881.

THE Fort Scott Coal and Mining Company, a Kansas corporation, issued stock to the defendant Thayer, upon payment of a part of the par value, and credited him with the balance unpaid by "discount." Certificates were issued for full-paid shares. The corporation became bankrupt, and the assignees sought to recover from Thayer the unpaid balance upon such shares.

MR. JUSTICE WOODS. The stock held by the defendant was evidenced by certificates of full-paid shares. It is conceded to have

been the contract between him and the company that he should never be called upon to pay any further assessments upon it. The same contract was made with all the other shareholders, and the fact was known to all. As between them and the company this was a perfectly valid agreement. It was not forbidden by the charter or by any law or public policy, and as between the company and the stockholders was just as binding as if it had been expressly authorized by the charter.

If the company, for the purpose of increasing its business, had called upon the stockholders to pay up that part of their stock, which had been satisfied "by discount" according to their contract, they could have successfully resisted such a demand. No suit could have been maintained by the company to collect the unpaid stock for such a purpose. The shares were issued as full paid, on a fair understanding, and that bound the company.

In fact, it has been held in recent English cases that not only is the company but its creditors also are bound by such a contract. *Waterhouse* v. *Jamieson*, Law Rep. 2 H.L. (Sc.) 29; *Currie's Case*, 3 DeG., J. & S. 367; *Carling, Hespeler, and Walsh's Cases*, 1 Ch.D. 115.

But the doctrine of this court is, that such a contract, though binding on the company, is a fraud in law on its creditors, which they can set aside; that when their rights intervene and their claims are to be satisfied, the stockholders can be required to pay their stock in full. *Sawyer* v. *Hoag, Assignee*, 17 Wall. 610; *New Albany* v. *Burke*, 11 id. 96; *Burke* v. *Smith*, 16 id. 390.

The reason is, that the stock subscribed is considered in equity as a trust fund for the payment of creditors. *Wood* v. *Dummer*, 3 Mass. 308; *Mumma* v. *Potomac Co.*, 8 Pet. 281; *Ogilvie* v. *Knox Insurance Co.*, 22 How. 387; *Sawyer* v. *Hoag*, *supra.* It is so held out to the public, who have no means of knowing the private contracts made between the corporation and its stockholders. The creditor has, therefore, the right to presume that the stock subscribed has been or will be paid up, and if it is not, a court of equity will at his instance require it to be paid.

NOTE. — See, *accord*, as to the liability to creditors of persons to whom stock is issued as a bonus or at a discount, *Vaughn* v. *Alabama National Bank*, 143 Ala. 572; *Wait* v. *McKee*, 95 Ark. 124; *Vermont Co.* v. *Declez Co.*, 135 Cal. 579; *New Haven Trust Co.* v. *Gaffney*, 73 Conn. 480 (insurance corporation); *Knight & Wall Co.* v. *Tampa Brick Co.*, 55 Fla. 728; *Bates* v. *Great Western Tel. Co.*, *134* Ill. 536; *Boulton Carbon Co.* v. *Mills*, 78 Iowa, 460; *Bank* v. *Northup*, 82 Kan. 638; *Haldeman* v. *Ainslie*, 82 Ky. 395; *Belknap* v. *Adams*, 49 La. Ann. 1350; *Barron* v. *Burrill*, 86 Me. 66; *Hooper* v. *Central Trust Co.*, 81 Md. 559; *Utica Fire Alarm Co.* v. *Waggoner Clock Co.*,

166 Mich. 618; *McConey* v. *Belton Oil Co.*, 97 Minn. 190 (cf. *Ross* v. *Kelly*, 36 Minn. 38; a mining corporation); *Skrainka* v. *Allen*, 76 Mo. 384; *Libby* v. *Mt. Monadnock Co.*, 67 N.H. 587; *Hebberd* v. *Southwestern Land & Cattle Co.*, 55 N.J. Eq. 18, 31; *Bernard* v. *Carr*, 167 N.C. 481; *McAllister* v. *American Hospital Ass'n*, 62 Or. 530; *Mathis* v. *Pridham*, 1 Tex. Civ. App. 58, 83; *Martin* v. *South Salem Land Co.*, 94 Va. 28; *Cox* v. *Dickie*, 48 Wash. 264; *Bank* v. *Belington Coal Co.*, 51 W.Va. 60, 80; *Gager* v. *Paul*, 111 Wis. 638.

GUARANTEE TRUST CO. *v.* DILWORTH COAL CO.

235 Pa. 594. 1912.

MR. JUSTICE BROWN. This proceeding is on a corporation mortgage, instituted in pursuance of a provision in it that, on default in payment of interest on the bonds secured by it, the trustee, upon request of the holders of one-third of the bonds, might proceed by *scire facias* on the mortgage and prosecute it to judgment, execution and sale of the property. The mortgage was given by the Dilworth Coal Company, which was adjudged a bankrupt after the writ was issued, and J. T. Blair, its trustee, was allowed to intervene for the purpose of making the defense that the bonds were still in the hands of the original owners and had not been paid for. This defense was regarded as unavailing by the learned trial judge, whose direction to the jury was that, if they should find there had been default in the payment of interest for a period of ninety days, and the trustee had been requested, in writing, by the holders of one-third of the bonds to proceed for the collection of the amount due on all of the bonds secured by the mortgage, their verdict should be for the plaintiff. A verdict was accordingly rendered in its favor for $338,125, and from the judgment entered thereon the defendant's trustee in bankruptcy has appealed.

It is hardly conceivable that the jury, if they had been permitted to do so, would have failed to find that not a single bond issued under the mortgage, in pursuance of the scheme adopted and carried out for the organization of the Dilworth Coal Company, had been paid for either in property or money. The facts as developed seem to clearly show this. In June, 1901, H. P. Dilworth and George M. Dilworth purchased from W. P. Dilworth for $63,622 his half interest in one hundred and thirteen acres of coal land situated in Jefferson township, Greene county. They owned the other half, and the total value of the whole, based upon what was paid for W. P. Gilworth's half, was $127,244. The purchasers immediately took steps to organize the Dilworth Coal Company. An organization agreement, which has been lost, was signed by them and others, who

are the beneficial plaintiffs below. That agreement — its contents having been established by parol testimony — provided that the Dilworth's coal land should be valued at $156,000, and for turning it over to the corporation they were to receive $156,000 in stock and $156,000 in first mortgage bonds of the company. The agreement further provided that the capital stock should be $300,000, and that a first mortgage should be placed on the property for $300,000, to secure the $156,000 of bonds which the Dilworths were to get, and $144,000 of bonds which were to be issued to others who were to contribute $144,000 as the balance of the capital stock. Each contributor was to be put on an equality with the Dilworths, and for every $1,000 cash contributed he was to receive $1,000 in stock and $1,000 in bonds secured by the $300,000 mortgage. The sum of $144,000 was contributed by different persons, and each one, for every $1,000 paid by him, received twenty shares of the capital stock of the company, at a par value of $50 per share, and a bond for $1,000. Just what the agreement was as carried out appears from the following taken from the testimony of H. P. Dilworth, one of the witnesses called by the plaintiff: "Q. What were the terms of this contract? A. My brother George, and myself put a value of $156,000 on the coal lands we owned, and we were to get $160,000 in bonds or $156,000 rather, and also were to get the same amount of stock of the Dilworth Company. Q. And what else was contributed to the company? A. To anybody else who paid $1,000 they were to get a $1,000 bond and $1,000 par value of the stock for their $1,000 cash. We made an assessment of a $1,000. Q. This agreement provided for the payment of $144,000 cash — cash to the extent of $144,000, took with it bonds and the same amount of stock? A. Yes, sir. Q. What were the parties contributing that to get? A. They were to get $1,000 worth of bonds which would entitle them to $1,000 in stock, equal amount of bonds, equal amount of stock. Q. For $144,000 in cash they were to receive bonds to the extent of $144,000, and also to the extent of $144,000 in stock, — now who were the parties who came into this agreement originally, — the Dilworth Coal Company? A. Eugene O'Neil, $10,000; Calvin Wells, $20,000; F. E. Richardson, $20,000; Pennock Hart, $10,000; Newton Hemphill, $12,000; J. H. Lockhart, $10,000; Henry Buhl, $15,000; J. M. Lockhart, $10,000; C. B. McLean, $20,000; G. A. McLean, $10,000; James Black, $4,000 and myself $3,000." This witness further testified as follows, when cross-examined by counsel for plaintiff: "Q. Mr. Dilworth, how did you pay for your stock? A. I gave my property. Q. Your property was duplicated in value, — that is, for $156,000 worth of property you received $156,000 worth of bonds and $156,000 stock? A. Yes, sir."

"No corporation shall issue stock or bonds except for money, labor done, or money or property actually received;" Const., Art.

XVI, § 7. What the organizers of the Dilworth Coal Company did was done in the face of this provision, but the jury were not permitted to pass upon the validity of the bonds issued to the subscribers to the capital stock of the company, even though they were still in the hands of the original holders. The question of the rights of innocent holders does not arise in this controversy, and there is no merit in the contention of the appellee that the validity of the bonds cannot be questioned because the bondholders did not have their day in court. The holders of the bonds who gave the notice to the trustees to proceed on the mortgage were those to whom $107,000 of the bonds had been issued under the agreement giving them $1,000 in stock and $1,000 in a bond for each $1,000 subscribed, and their holdings were unchanged from the time they received them. They cannot, therefore, be said to have been denied their day in court, for they themselves caused this proceeding to be instituted. H. P. Dilworth testified that he was still the owner of the $81,000 of bonds originally issued to him, and had acquired the $78,000 originally issued to his brother George. E. M. O'Neil, who had received $10,000 of the bonds, was represented on the trial by his general agent, who testified that he still held the bonds. It thus appeared that original holders of $276,000 of the bonds had notice of this proceeding. Of the remaining bonds it was testified that C. B. McLean was still the owner of the $20,000 of bonds originally issued to him, and an unchallenged statement of counsel for appellant is that James Black, an original subscriber to $4,000 of the bonds, which he still held, was present at the trial. All the original holders of the bonds with the possible exception of C. B. McLean, seem to have had notice of this proceeding, and there was ample evidence to justify the jury in finding that the entire issue was void.

If it had affirmatively appeared that cash or property to the value of $600,000 had actually been turned over to the coal company, a different situation would be presented; but, from what appeared on the trial, the conclusion seems to be unavoidable that all the company got was property and money amounting in value to but $300,000, and that all the parties to the scheme of organization understood this. Of a situation very similar to the one before us Mr. Justice LURTON, now of the Supreme Court of the United States, aptly said: "Whether this 'basis of organization' be construed to be a contract whereby each subscriber to the stock was to be given a bond as a bonus, or each subscriber to the bonds was to be given paid-up stock as a bonus, or as an agreement by which each contributor to the capital stock was to receive the obligation of the company, secured by a primary mortgage, that he should be repaid the amount of his subscription, with interest, such an agreement would clearly be illegal and ineffective as to existing or subsequent

creditors of the corporation, upon the ground that the payment for the stock was unreal and simulated, or that the bond had been issued upon no consideration: 2 Morawetz, Priv. Corp. § 824; *Sawyer* v. *Hoag*, 84 U.S. (17 Wall.) 610; *Scovill* v. *Thayer*, 105 U.S. 143. . . . It was an arrangement whereby the franchise was to be secured, and at the same time deprive the public of the security which by law they are entitled to have, and upon which the grant of the franchise depends. Whatever the real motive and purpose of the promoters of this arrangement may have been, its legal effect, if valid, would have been to throw all the risks and hazards of the business upon the public who should deal with it; while the contributors were to reap all possible gains, and should be secured against loss in the event the enterprise prove unprofitable. Is a contract by which a corporation agrees to repay to the contributors of its capital stock their several contributions, and whereby such contributions are converted into corporate debts, valid even as against the corporation? Upon what consideration does such an agreement rest? And what power has a corporation to bind itself by such a contract?" *Morrow* v. *Nashville Iron, Steel & Charcoal Co.*, 3 L.R.A. 37.

The validity of the bonds issued by the Dilworth Coal Company was clearly for the jury.

All of the assignments of error are sustained and the judgment is reversed with a *venire facias de novo*.

NOTE. — And see *Brown* v. *Clow*, 158 Ind. 403; *Morrow* v. *Iron & Steel Co.*, 87 Tenn. 262; *Rolapp* v. *Ogden R.R. Co.*, 37 Utah 540.

Cf. *Broderip* v. *Salomon*, [1897] A.C. 22, *supra*.

SOUTHWORTH *v.* MORGAN.

205 N.Y. 293. 1912.

COLLIN, J. The plaintiff, trustee of the bankrupt corporation, Remington Automobile & Motor Company, seeks to recover from the defendant a sum unpaid, as plaintiff alleges, upon a subscription by the defendant for two shares of the capital stock of the corporation.

The trial court found as facts: The bankrupt was organized in 1900 under the laws of New Jersey. Its authorized capital stock was $250,000, divided into twenty-five hundred shares of the par value of $100 each. Soon after its incorporation, the board of directors adopted a resolution as follows: "*Resolved*, that for the purpose of securing a local interest in the Remington Automobile & Motor Company on the part of the citizens of Ilion (N.Y.) that 200 shares of the stock be issued, to be sold at $25 per share, and that the pro-

ceeds of such sale be placed in the treasury to be used for regular expenses." Thereafter, in pursuance of the resolution, the general manager and secretary of the corporation presented to the defendant a writing which contained the agreements that the plant of the corporation was to be located and its business to be carried on at Ilion, and that the defendant would purchase two non-assessable shares of the capital stock of the corporation at $25 for each share and no more would ever have to be paid upon them. The defendant signed the agreement and purchased the two shares of stock upon the distinct understanding and agreement made between the defendant and the general manager and secretary of the corporation that $25 per share fully paid for the stock. He paid $50 for the two shares of stock at the time he received them. The corporation located its plant at Utica, New York, and not at Ilion. In December, 1902, the company was adjudged a bankrupt, and in April, 1906, the United States District Court granted an order directing a call or assessment upon the defendant and others of $75 per share to meet the deficiency in the assets of said corporation to meet the obligations of its creditors, said assessments to be paid on or before July 1, 1906, and the defendant was duly served with a copy of said order. The court found as a conclusion of law that the plaintiff was entitled to recover the sum of $150, a conclusion which the facts found do not support.

The liability of the defendant is to be determined by the law of the state of New Jersey. That state, through its laws, gave the corporation its existence, powers, liabilities and the limits within which it was free to act, and a citizen of this state, who became a shareholder in it, entered into contract relations, the extent and obligation of which depend upon those laws, in so far as they do not violate a statute or the settled public policy of this state. *Lowry* v. *Inman*, 46 N.Y. 119; *Hancock National Bank* v. *Ellis*, 166 Mass. 414; *Molson's Bank* v. *Boardman*, 47 Hun, 135. The relevant laws of New Jersey are not disclosed or laid before us by the printed record; nor do the findings make known the provisions of the charter of the bankrupt other than that stated relating to the authorized capital stock. We are confined to the case as the record presents it. The laws of other states are facts which must be alleged and proved and of which we cannot take judicial notice either in their language or their interpretation. *Genet* v. *Del. & Hud. Canal Co.*, 163 N.Y. 173, 177; *Hancock National Bank* v. *Ellis*, 166 Mass. 414. In the absence of those facts we must presume that the common law of New Jersey is the same as the common law of New York. *Ruse* v. *Mut. Benefit Life Ins. Co.*, 23 N.Y. 516, 522.

It is urged by the respondent, at this point, that the order of the United States District Court directing the assessment of the shares of the defendant conclusively determined the validity and the amount of the assessment. It is true that the regularity and validity

of the proceeding in that court and its conclusions cannot be attacked in this action; but the existence or non-existence of an obligation on the part of the defendant to pay the assessment was not within the subject-matter of which that court took jurisdiction. To enable the plaintiff to enforce the liability of the delinquent shareholders to the extent only which the deficiency in the corporate assets required and to effect parity of contribution between them it was necessary that an account of the assets and debts, of the entire amount of the capital remaining unpaid upon the issued shares, and the part of the face value of his shares unpaid by each stockholder should be taken, and the aggregate assessment required equitably rated by the court, and it is upon those issues that its order is beyond attack in this action. *Great Western Telegraph Co.* v. *Purdy*, 162 U. S. 329; *Howarth* v. *Angle*, 162 N.Y. 179. In the former case the court, speaking of an analogous order of a court of Illinois, said: "But the order was not, and did not purport to be, a judgment against any one. It did not undertake to determine the question whether any particular stockholder was or was not liable in any amount. It did not merge the cause of action of the company against any stockholder on his contract of subscription, nor deprive him of the right, when sued for an assessment, to rely on any defense which he might have to an action upon that contract" (p. 337). The respondent does not contend that the charter provision dividing the authorized capital stock into shares "of the par value of $100 each" prohibited the creation of an actual share or interest upon a consideration less than $100, or secures to the creditors or their representative the right of collecting upon each share, as the discharge of the corporate debts demands, the difference between the consideration and $100.

Inasmuch as no statute of the state of New Jersey, nor provision of the charter of the corporation relative to the liability of the defendant, was proven, we turn to the common law, remarking parenthetically, however, that we have not been referred to and have not found any domestic statute which prescribes, as a condition to the exercise here of the rights derived from the state of New Jersey that the shareholders shall be liable to the creditors or their representative up to the nominal value of their stock, and there is, therefore, no statutory, as there is no charter, prohibition against the issuance of the shares of the capital stock for less than their par value as named in the charter, and no statutory mandate that the shares shall be deemed issued and held subject to the payment of such value. Nor do the principles of the common law of this state work such results. In *Christensen* v. *Eno*, 106 N.Y. 97, the action was brought by a judgment creditor of an insolvent corporation organized under the laws of Illinois to recover forty per cent of the authorized par value of $100 each of twenty-five shares of the stock of the company issued

to but unsubscribed for by the defendant, upon which the forty per cent was not paid, but, as a gratuity, was credited as paid, when the stock was issued. Judge ANDREWS, writing for this court, which reversed the judgment in favor of the plaintiff, said (citing authorities): "But the liability of a shareholder to pay for stock does not arise out of his relation, but depends upon his contract, express or implied, or upon some statute, and in the absence of either of these grounds of liability, we do not perceive how a person to whom shares have been issued as a gratuity has, by accepting them, committed any wrong upon creditors, or made himself liable to pay the nominal face of the shares as upon a subscription or contract" (p. 102). The principles which determined our judgment in that case were reaffirmed in *Christensen* v. *Colby*, 110 N.Y. 660. In the case at bar, no statute supports the alleged liability of the defendant, and the express agreement between the corporation and the defendant was that the defendant should pay twenty-five per cent of the nominal value of the shares and no more. The respondent contends, however, and therein he has been successful in the courts below, that the creditors of the corporation represented by the plaintiff, have the right to compel the payment of the unpaid seventy-five per cent, because the capital stock is a trust fund for the security of the creditors, and that a liability in their favor to the extent of the unpaid part of the nominal value of the actual shares exists and can be enforced. Such contention availed the plaintiff in the *Christensen Case* until it reached this court, the General Term saying therein that the practical effect of the transaction was to take out of the assets, to which the creditors were entitled, the forty per cent indorsed as paid upon the stock, when in fact it was not paid. It is strenuously urged that this case is not controlled by the principles which decided the *Christensen Case*, for the reason that the defendant subscribed for the two shares of the capital stock, while in the *Christensen Case* the stock certificate was merely issued to and accepted by the defendant. The subscription, as expressed in the agreement between the defendant and the corporation, has been completely fulfilled by the payment in full of the sum it bound him to contribute and therewith his liability to the corporation or the creditors terminated, unless there issued from the trust fund doctrine, through implication, a contract which, in the paramountcy given it by the fact that it was the irresistible product of the law, nullified the expressed stipulation that $25 was the whole sum to be paid upon each share, and substituted in its place the requirement that, as to the creditors, there should be paid $100 or so much thereof as the satisfaction of their demands made necessary. That doctrine has not such potency. Its peculiar vigor is, that contrary to the common law of England, it secures to the creditors of insolvent corporations or their representatives the right of enforcing subscriptions for shares of which the corporation has

deprived itself by release or defeasance. It declares that the capital or capital stock of a corporation is a substitute for the personal liability which subsists in individual or partnership undertakings and is a fund set apart as a security for the payment of the corporate debts. The capital or capital stock which it thus segregates is not the capital stock authorized or named in the charter of the corporation. If it were the members would be bound by the doctrine to contribute on account of it the sum within its named value needed to pay the debts of the insolvent corporation. The statement in the charter does not create a security for the creditors. It creates authorized or potential capital stock and shares which, transferred into actual shares through the acquisition of subscribing members and their payments, produces the money or property which, put into a single corporate fund, is the actual capital or capital stock on which the business is undertaken and the assets or fund contemplated by the trust fund doctrine which the directors or stockholders may not lawfully diminish by appropriating or squandering it or giving it away. And as there is not a fund or security in the nominal or potential shares, there is none in the excess of the nominal value over the subscribed value of the shares. The subscription agreements, as they are enforceable through their express provisions or implication or statutory conditions, are the sources and the measure of the duty of the subscribers. *Christensen* v. *Eno*, 106 N.Y. 97; *Burrall* v. *Bushwick Railroad Co.*, 75 N.Y. 211. The doctrine further declares that unpaid subscriptions are a part of the capital and that a subscriber cannot be discharged to the injury of creditors by arrangement or device to which creditors do not give their assent and by which he is to pay less than his subscription. *Stoddard* v. *Lum*, 159 N.Y. 265; *Ward* v. *City Trust Co.*, 192 N.Y. 61; *Hazard* v. *Wight*, 201 N.Y. 399. The doctrine does not create or nullify subscriptions. It lays hold of the assets of an insolvent corporation, and in doing that it compels subscribers to fulfill their legal obligations and perform their legal duties; but it does not beget those duties or obligations; it does not make unlawful or invalid a subscription which, apart from it, was valid and lawful. The question with it is, has the subscriber fully performed the subscription agreement as it in fact and in law exists, and an affirmative finding renders it inapplicable and inoperative. In the case at bar there were not statutory conditions upon which the shares might be owned. The agreement between the defendant and the corporation expressed with completeness the obligation and liability of the defendant for his shares. He has fulfilled the obligation and thereby destroyed the liability. The trust fund doctrine is inapplicable and the findings of fact do not constitute a cause of action.

We have not considered or determined either the manner or the extent in which a statute of New Jersey, inimical to the express agreement of the corporation and the defendant, would through im-

plication affect it, or the effect of the statement of the corporation that it would locate its plant and carry on its business at Ilion, because the record submitted to us does not present those questions.

The judgment should be reversed and a new trial granted, costs to abide the event.

HAIGHT, VANN, WILLARD BARTLETT, HISCOCK and CHASE, JJ., concur; CULLEN, Ch.J., concurs in memorandum, as follows:

CULLEN, Ch.J. I concur on the sole ground that, as shown in the opinion of COLLIN, J., the question involved in the appeal is settled by the authority of the previous decisions of this court. Were it an original one I should reach a contrary conclusion.

Judgment reversed, etc.

NOTE. — See *Bent* v. *Underdown*, 156 Ind. 516 (creditors affected with notice of a provision in articles of association); *Ross* v. *Kelly*, 36 Minn. 38 (mining corporation).

COFFIN *v.* RANSDELL.

110 Ind. 417. 1886.

MITCHELL, J. Daniel M. Ransdell, as receiver of the Unthank Plow Company, a corporation organized under the law of the State of Indiana, brought this suit against Francis A. Coffin, a shareholder, to recover an alleged balance due upon his stock subscription. He alleges that he brings the suit by the especial direction of the court, under whose appointment he is acting as receiver.

From the facts put forward in the complaint, and relied on as a ground of recovery, it appears that the Unthank Plow Company was organized on the 13th day of July, 1881, by Daniel Unthank, Francis A. Coffin and William E. Coffin. The capital stock was fixed at $50,000, divided into 1,000 shares of $50 each. Articles of association were filed, as required by law. These are embodied in the complaint.

"The object and business of the corporation," as set forth in its articles of association, "is the manufacture and sale of agricultural implements, and other articles and machinery, and also to acquire, purchase, and hold letters-patent for such patented articles as it may desire to manufacture."

The three corporators were named in the articles as directors. The articles of association concluded as follows: "The undersigned hereby associate themselves together for the purpose of forming this corporation, and severally subscribe the amount of stock set opposite their names. (Signed)

"DANIEL UNTHANK, 499 shares.
"FRANCIS A. COFFIN, 499 shares.
"WILLIAM E. COFFIN, 2 shares."

These articles were signed July 13th, 1881.

The complaint avers that the corporation was organized as the successor of Unthank & Coffin, a partnership, engaged in the same business as that proposed to be conducted by the corporation, and that the members of the late firm were Daniel Unthank and Francis A. Coffin.

It is charged that the only manner in which there was ever any payment, or pretence of payment, of the stock severally subscribed by Daniel Unthank and Francis Coffin, or either of them, was by turning over to the corporation the property and assets of the firm of Unthank & Coffin, which property and assets, the plaintiff avers, the subscribers, Unthank and Coffin, well knew were no more than one-fourth the amount of the stock so subscribed by them.

Unthank and Coffin, it is alleged, each owned one-half of the property so turned over in payment of their respective subscriptions. It is averred that the property so transferred consisted in part of letters-patent, securing the right to manufacture plows of a certain kind, which letters-patent, it is alleged, were turned in at a valuation of $27,000, each of the late partners taking credit on his subscription for one-half that amount. Plows, and material on hand for the manufacture of plows, estimated at $3,000, were in like manner applied, as were also bills receivable, and credit accounts of the late firm, amounting to $9,000. The balance of the subscription was paid, the complaint avers, "by turning in other alleged assets of Unthank & Coffin, which were not assets at all." What these alleged assets were, or their value, is not stated. It is charged in general terms, that the letters-patent, and other articles and assets so turned in and applied, were vastly overestimated in value; that the bills receivable were worth less than one-half the amount they were credited for on the subscriptions, all of which it is alleged was well known to the defendant.

From the facts as set forth, and which are substantially stated above, the conclusion is drawn, that the defendant is indebted for at least 75 per cent. of his original stock subscription. An accounting and judgment are prayed.

The appellant contends that the facts stated do not constitute a cause of action against him, and hence that the court below erred in overruling his demurrer to the complaint.

It is fairly inferable from the facts disclosed, that at or subsequent to the incorporation of the company, it was agreed between the directors of the corporation and the defendant, that his interest in the property and assets of the firm of Unthank & Coffin should be transferred and accepted in full payment of his subscription to the stock of the Unthank Plow Company, and that it was so transferred and accepted. The *gravamen* of the plaintiff's case is, that because there was an overvaluation of the property, the transfer and accept-

ance constituted, as against subsequent creditors of the corporation, payment *pro tanto* only.

Assuming as receiver to represent the creditors of the corporation, the plaintiff, in his official or representative character, asserts the right to ascertain the real value of the property and assets transferred, and to recover from the defendant the difference between such value and the amount subscribed by him, as unpaid subscription.

It is to be noted that there is an entire absence of any charge or suggestion that the corporation was in any way misled or overreached by the defendant, as to the situation or value of the property; nor does it appear that the transaction was merely colorable, or a mere device on the part of the corporators to absorb the capital stock of the corporation without making what was regarded, and agreed upon, as an equivalent in payment.

The inference is, that the board of directors, comprising all the stockholders, with full knowledge of all the facts, accepted the property and assets in question as payment, and without any fraudulent intent consummated the transaction, which stood without question until it was assailed by the receiver in the manner stated.

It is to be observed, further, that this is not a suit to rescind or set aside the transfer and acceptance of the property, or any part of it, as fraudulent, nor is there any pretence that the transaction was *ultra vires* and void. From the frame of the complaint, and in all its distinctive features, the action is purely a suit at law to collect unpaid subscription to stock.

Accepting the situation, and the property as he found it, the receiver simply says, that the only payment, or pretence of payment, which the defendant ever made of his subscription, was in the manner stated, and that because the property taken in payment was knowingly overvalued by the defendant, and the other corporators, the difference between the actual value of the property and assets so taken, and the amount of the defendant's subscription, remains unpaid.

The argument in support of the judgment of the court below, which was for the plaintiff, rests upon the proposition that the capital stock of a corporation, especially the unpaid subscriptions to such stock, constitutes a trust fund for the benefit of the general creditors of the corporation. This being so, it is argued that the representative of the creditors "has the right as against anybody, and as against any settlement or contract to which they were not parties, to inquire into the state of the fund, and to insist that all who are really indebted be compelled to pay."

That subscriptions to the capital stock of a corporation are required to be made in good faith, can not be doubted. Simulated subscriptions by persons who have neither the ability nor purpose to pay, and arrangements between the subscribers and the agents or

promoters of a corporation, that subscriptions shall be merely colorable, are a fraud upon the law. This much was decided in the recent case of *Holman* v. *State, ex rel.*, 105 Ind. 569.

The legislative purpose in making provision for corporate organizations was, that subscriptions to the capital stock should constitute a fund, or capital, with which to purchase property necessary for the corporate business, and to enable the corporation to engage in and carry out the purpose of its organization. It is upon the faith of its capital stock, either paid in and invested in available property and corporate assets, or to be paid in, that credit may be extended to the corporation. Having paid, or agreed to pay, their subscriptions for stock, is the consideration upon which the several corporators enjoy exemption from personal liability for corporate debts, except as such liability may be imposed by statute.

It follows necessarily that unpaid subscriptions to the capital stock of a corporation constitute a trust fund for the benefit of creditors; and it follows also, that the officers of the corporation, who are trustees in respect to its property and funds, can not purposely or fraudulently waste or dissipate the corporate assets, nor can they defeat or impair the trust, by accepting merely simulated or fictitious payment of stock subscriptions, or by any other device short of an actual payment of that which is in good faith taken as an equivalent for the stock. *Scovill* v. *Thayer*, 105 U.S. 143; *Sawyer* v. *Hoag*, 17 Wall. 610; *Osgood* v. *King*, 42 Iowa, 478; *Wetherbee* v. *Baker*, 35 N.J. Eq. 501; *Boynton* v. *Hatch*, 47 N.Y. 225; *Crawford* v. *Rohrer*, 59 Md. 599; Thompson Stockholders, § 129; Morawetz Corp., §§ 423, 824, 825.

Any arrangement, therefore, between a stockholder and the officers or agents of a corporation, by which paid-up shares of stock are issued upon merely simulated or nominal payment, whether such payment be made in money or property, is regarded, as between the stockholders and the creditors of the corporation, as a sham, and hence no payment at all. Such payments, like simulated subscriptions, are an evasion of the law, and are, therefore, fraudulent and void.

The affirmation of the foregoing propositions does not, however, meet the exigencies of the plaintiff's case. Having averred an actual substantial payment to, and acceptance by, the corporation of valuable property, while that transaction remains unimpeached and unrescinded, the necessities of the plaintiff's case required that he should show a state of facts which rendered the transaction *ultra vires* and void, or that it was so infected with fraud and bad faith, as that the creditors might treat it as void, without setting it aside.

Whatever may have been formerly held, it is now established that subscriptions to corporate stock need not, in the absence of statutory provisions requiring it, be paid for in cash. The principle is now gen-

erally accepted, both in England and America, that any property which the corporation is authorized to purchase, or which is necessary for the purposes of its legitimate business, may be received in payment for its stock. Any payment, whether it be in money or money's worth, so that it be made in good faith, will give the shares so paid for the status of paid-up stock. In the language of Lord Justice GIFFARD, in *Drummond's Case*, L.R. 4 Ch. Ap. 772: "If a man contracts to take shares he must pay for them, to use a homely phrase, 'in meal or in malt;' he must either pay in money or in money's worth. If he pays in one or the other, that will be a satisfaction." *Fletcher* v. *McGill*, *ante*, p. 395; *Cincinnati, etc., R.R. Co.* v. *Clarkson*, 7 Ind. 595; *State* v. *Baily*, 16 Ind. 46; *Phelan* v. *Hazard*, 5 Dill. 45; *Van Cott* v. *Van Brunt*, 82 N.Y. 535; *Lorillard* v. *Clyde*, 86 N.Y. 384; *Carr* v. *Le Fevre*, 27 Pa. St. 413; *Philadelphia, etc., R.R. Co.* v. *Hickman*, 28 Pa. St. 318; *Pittsburgh, etc., R.R. Co.* v. *Stewart*, 41 Pa. St. 54; *Foreman* v. *Bigelow*, 4 Cliff. 508; *Liebke* v. *Knapp*, 79 Mo. 22; *Foster* v. *Seymour*, 6 Am. & Eng. Corp. Cases, 533; *Crawford* v. *Rohrer*, *supra; In re Baglan Hall Colliery Co.*, L.R. 5 Ch. Ap. 346; *Pell's Case*, L.R. 5 Ch. Ap. 11; *Spargo's Case*, L.R. 8 Ch. Ap. 407; *In re Cape Breton Co. Limited*, 50 Law Times, N.S. 390; 18 Am. Law Rev. 256; Thompson Stockholders, §§ 127–130; Morawetz Corp., §§ 425, 428, 825, 826.

The foregoing, and many other cases which might be cited, afford examples of transactions, such as that here involved, between the owners of property and corporations which they formed, which, in the absence of fraud, have been sustained by the courts.

As shown by the articles of association, the Unthank Plow Company was organized for the purpose of engaging in the manufacture of plows and other agricultural implements, and also to acquire, purchase, and hold letters-patent, for such articles as it should engage in the manufacture of.

The contract to receive in payment the letters-patent, plows, material, and other assets of its predecessor, Unthank & Coffin, was, therefore, not *ultra vires*. *Lyon* v. *Ewings*, 17 Wis. 63; *Clark* v. *Farrington*, 11 Wis. 306; *Blunt* v. *Walker*, 11 Wis. 334; *Cornell* v. *Hichens*, 11 Wis. 353.

Does the fact that the property was received at an overvaluation, enable the receiver to maintain this suit without impeaching or setting the transaction aside, if it can be set aside? No proposition can be plainer, upon the facts as stated, than that the title to the property and assets which were transferred to the corporation passed to and remains in it, or in the receiver, and that the title and ownership of the stock thereby paid for vested in the defendant. The transaction having been, so far as appears, fully executed years before the receiver was appointed, may he permit it to stand and now treat it as so far void as to ask for a new valuation of the property? May

he disaffirm the contract in part, and affirm as to the residue? We have been unable to discover any principle or well considered authority which affirms this proposition.

The principle deducible from the authorities already cited is, that even in case of an overvaluation of property transferred to a corporation in payment of shares, the transaction, unless void for some reason, is binding so long as it is not impeached by the corporation, or its assignee; and it can be impeached only for fraud upon the corporation. *Coit* v. *Gold Amalgamating Co.*, 119 U.S. 343; *Phelan* v. *Hazard, supra; Brant* v. *Ehlen*, 59 Md. 1.

Thus it has been held that a mining corporation may issue shares to its creditors as fully paid up, in consideration of mining lands, and although these lands be greatly overvalued, the assignee in bankruptcy of the corporation can not, without disaffirming the contract, set up the claim that the property was not worth what it was valued at. *Foreman* v. *Bigelow, supra.* So in *Phelan* v. *Hazard, supra*, a case closely analogous in its facts to the one under consideration, Judge DILLON said: "While the contract stands unimpeached, the courts, even where the rights of creditors are involved, will treat *that* as a payment which the parties have agreed should be payment."

A standard author concludes a careful and exhaustive examination of this subject thus: "The whole discussion resolves itself into the following conclusions: A corporation may take in payment of its shares any property which it may lawfully purchase. Such a transaction is not *ultra vires* or void, but is valid and binding upon the original share-takers and upon the corporation, unless it is rescinded or set aside for fraud. While such a contract stands unimpeached, the courts, even where the rights of creditors are involved, will treat that as payment which the parties have agreed should be payment." Thompson Stock., § 134.

"Many attempts," says another learned author, "have been made, in cases where stock was issued for property taken at an overvaluation, to hold the party receiving such stock liable for its full par value, less the actual value of the property received from him. These attempts have not been successful. As already seen, the transaction is upheld as legal, valid, and binding on all parties and persons, unless there is an overvaluation, and that overvaluation is shown to have been fraudulent. When this is proved, then the contract is to be treated like other fraudulent contracts. It is to be adopted *in toto*, or rescinded *in toto* and set aside. Each party is to be restored as nearly as possible to their original positions. The property or its value is to be returned to the person receiving the stock, and he must return the stock or its real value. Its real value is ascertained, not by its par value, but by its selling market value." Cook, Stock and Stockholders, § 47.

The contract, not being void, must be disaffirmed and set aside,

before the receiver can maintain an action at law as for unpaid subscriptions. *Scovill* v. *Thayer, supra.*

Suppose it be true, that in consummating the arrangement, the property of Unthank & Coffin was turned in to the corporation at an overvaluation, and that the defendant and the other corporators participated in the alleged wrong. The transaction was the result of an agreement which the parties had the right as between themselves to make. Being corporators, they had the right to fix the amount of the capital stock. It was competent for them to estimate the value of their own property. The property was such as was suited to the proposed business of the corporation. Can the court now arbitrarily say that because they estimated their property too high, the defendant shall now be compelled to pay par for his stock, and yet take a price for his property which he never agreed to? Shall he be capriciously punished, by being made liable *ex contractu*, upon a contract which he never made? If the defendant has participated in a fraud, whereby the creditors of the corporation, who exercised ordinary business sagacity, have suffered damage, whatever redress such creditors may now obtain, while their representative retains the defendant's property, must be sought by an action *ex delicto*.

In the case of *In re Baglan Hall Colliery Co., supra*, where a colliery had been turned over to a corporation in payment for stock subscriptions, and where a question of overvaluation was made, Lord Justice GIFFARD said: "The test to be applied is this: could the company by any proceeding have set aside the transaction by which it was arranged that the owners of the colliery were to have paid-up shares as the price of their interests in the colliery? . . . There is nothing in the evidence to show that any person has been deceived. . . . The case is precisely the same as *Pell's Case*, . . . and it must be held that the persons who subscribed the memorandum of association have paid all that they were bound to pay. Creditors have no ground for complaint, for persons who are about to enter into transactions of magnitude with an individual, make inquiry into the state of his circumstances; and so, if they enter into them with a limited company, it is their own fault if they do not inquire into the nature of the memorandum and articles, and look to the register of shareholders."

Examination of the articles of the corporation here involved would have disclosed that the business of the company was the manufacture of plows and other implements, and to acquire and own patent rights.

The register of stockholders doubtless would have disclosed to any one examining it, that the stock subscribed had been paid up. Inquiry doubtless would have disclosed the manner of payment. The solvency of the company depended then upon the nature and value of its property and assets. If there was no fraud or concealment after

the transaction in question was consummated, it is not perceived how the creditors were defrauded by reason of an overvaluation of the property, which was turned over in payment of the stock, any more than they would have been if the subscribers had paid in cash for their stock, and the corporation had then invested the money in patents and other property, which could now be shown was purchased at a price in excess of their value.

The fact is well known that many of the corporate enterprises now in progress have been projected by persons who contributed their inventions, or their skilled services and experience in business at a fixed price, or perhaps what was rescued from the wreck of some previous enterprise, and nothing else, in payment of subscriptions to capital stock. It could not be tolerated, in the event of an adverse outcome, that, notwithstanding the utmost good faith may have been observed in making such contribution or payment, and in disclosing all the facts, creditors, who were in no way misled, could now, by simply asserting an overvaluation of what had been agreed upon and accepted as payment of subscriptions, enforce contracts which were never made.

Patent-rights and mining and manufacturing property, which are embarked in enterprises, are frequently valued by their owners and others at a prospective value, which may or may not be realized, dependent upon future contingencies. If the owners, who put such valuations thereon, act in good faith, and yet suffer disappointment, we can see no reason why they should suffer further, unless they have been guilty of fraud or concealment, which has resulted in damage to others.

Our conclusion is, that the complaint states no cause of action, and that the court erred in overruling the appellant's demurrer. This renders it unnecessary that we should consider other questions discussed.

Judgment reversed, with costs.

NOTE. — See, *accord*, *Horton* v. *Sherrill-Russell Lumber Co.*, 147 Ky. 226 (the corporation was not a Kentucky corporation); *Brant* v. *Ehlen*, 59 Md. 1 (but *cf. Crawford* v. *Rohrer*, 59 Md. 599); *Bank* v. *Belington Coal Co.*, 51 W.Va. 60.

MONK *v.* BARNETT.

113 Va. 635. 1912.

CARDWELL, J., delivered the opinion of the court.

This case, which is now before us for the second time, originated in a bill in equity filed by appellants against the Exposition Deep-

water Pier Corporation and appellees, C. M. Barnett, J. W. Hough, and H. B. Goodridge, who were the only stockholders and incorporators of said corporation; the purpose of the bill being to enforce the mechanic's lien of the appellants against the pier and land of the Exposition Deepwater Pier Corporation, and to require the stockholders of the corporation to pay in full their subscriptions to the capital stock of the company.

There were two questions presented upon the former appeal, and upon the first of these questions this court reversed the decree of the circuit court appealed from, and remanded the cause, declining to pass upon the second question, for the reason that it appeared from the evidence in the record that the property of the corporation was sufficient to pay appellants' lien debt thereon; but the opinion added: "If, however, the real estate should prove inadequate to satisfy the lien, the appellants are not to be concluded by the decree under review from seeking such relief as they may be entitled to, if any, against the stockholders." *Monk* v. *Exposition Deepwater Pier Corp.*, 111 Va. 121, 68 S.E. 280.

It appears that when the evidence in the cause was taken the pier was comparatively new, and was supposed to be worth the amount named by the witnesses — $10,000; but, from various causes operating during the delay because of litigation as to the rights of the respective creditors in the property, it, after full advertising and active bidding, brought at public auction, on September 17, 1910, only $2,400, leaving about $4,000 still due appellants. Thereupon, appellants proceeded in their effort to obtain a decree against said stockholders for an amount sufficient, out of what remained unpaid of their subscriptions, to discharge the balance of the debt alleged to be due appellants; but, upon a final hearing of the cause, the circuit court entered its decree, now under review, holding that said stockholders had substantially complied with the provisions of the Constitution and statutes of the State "enacted for the formation and regulation of corporations in this State, and that said stockholders (appellees here) had paid in full their subscriptions to the stock of the Exposition Deepwater Pier Corporation, and that there was no further liability upon them, or either of them," dismissing appellants' bill as to said stockholders.

Appellees, Barnett, Hough, and Goodridge, who, as has been stated, were all the stock subscribers and incorporators of said Deepwater Pier Corporation at the time of its organization, filed with the State Corporation Commission, in March, 1907, a statement of the financial plan upon the basis of which the stock or bonds of the corporation were to be issued, and the contention of appellants is that said statement filed by appellees was not such a compliance with the provisions of § 167 of the Constitution of Virginia, and of § 1105e, paragraph 9, of the Code of 1904, as would avail ap-

pelles of the privilege extended by the statute of avoiding their common law liability to pay into the treasury of the company so much of their stock subscriptions, up to the par value thereof, as might be necessary to discharge the indebtedness of the corporation.

Section 167 of the Constitution, *supra*, confers upon the General Assembly power to make general laws regulating and controlling all issues of stock and bonds by corporations, and further provides: "Whenever stock or bonds are to be issued by a corporation it shall, before issuing the same, file with the State Corporation Commission a statement (verified by the president or secretary of the corporation, and in such form as may be prescribed or permitted by the commission), setting forth fully and accurately the basis, or financial plan, upon which such stock or bonds are to be issued; and where such basis or plan includes services or property (other than money), received or to be received by the company, such statement shall accurately specify and describe, in the manner prescribed or permitted by the commission, the services and property, together with the valuation at which the same are received, or to be received; and such corporation shall comply with any other requirements and restrictions which may be imposed by law." Said section of the Constitution then required the General Assembly to provide adequate penalties for the violation of the section, or any laws passed in pursuance thereof.

The statute (paragraph 9, § 1105e, *supra*) provides: "Subscriptions to the capital stock of any corporation may be paid in money, land, or other property, real or personal, leases, options, mines, mineral rights, patent rights, rights of way, or other rights or easements, contracts, labor, or services; and there shall be no individual or personal liability on any subscriber beyond the obligation to comply with such terms as he may have agreed to in his contract of subscription; and any corporation may adopt such plan of financial organization and may dispose of its stock or bonds for the purposes of its incorporation at such prices, for such consideration, and on such terms and conditions as it sees fit; provided, however, that before making any issue of its stock or bonds it shall file with the State Corporation Commission a statement (verified by oath of the president or secretary of the corporation, and in such form as may be prescribed or permitted by the commission), setting forth fully and accurately the basis or financial plan upon which such stock and bonds are to be issued; and where such basis or plan includes services or property (other than money), received or to be received by the corporation, such statement shall accurately specify and describe, in the manner prescribed or permitted by the commission, the services and property, together with the valuation at which the same are received, or to be received, and the judgment of the directors as to the value of such land or other property, real

or personal, leases, options, mines, mineral rights, patent rights, rights of way, or other rights or easements, contracts, labor, or services, in the absence of fraud, participated in by both parties to the transaction, shall be conclusive.

"For any violation of this section the offending corporation shall be liable to a fine of not exceeding one thousand dollars, to be imposed and judgment entered therefor by the State Corporation Commission, and shall be enforced by its process."

The financial plan, filed with the State Corporation Commission in this instance, is as follows: "Four hundred shares, valued at four thousand dollars, are to be issued to J. W. Hough, H. B. Goodridge, and C. M. Barnett, as fully paid, in consideration of their turning over to said company their options, rights, and contracts to acquire land and build a pier near the exposition grounds, and their contracts with various steamboat lines to use said pier exclusively in taking passengers to said grounds, and contracts with said steamboat companies, and with the Jamestown Exposition Company to take and pay cash for certain bonds of this company, said rights, options, and contracts being valued at four thousand dollars."

It appears that appellees subscribed to $40,000 of the stock of the Deepwater Pier Corporation, and paid for it with the contracts and options named in said plan of organization, all of which were worth, according to their own valuation, but $4,000; and it is conceded in the argument of this appeal that "the very object of section 167 of the Constitution was to do away with the common law liability of stockholders," under which they could be required to pay (in money) for their stock, up to the par value thereof, until the debts of the company were satisfied.

Very clearly, the provisions of the Constitution and statute change the former rule, and persons organizing a corporation can subscribe to its capital stock, and pay therefor in anything which the board of directors may determine to accept, and at any price which may be agreed upon, and the stock may be paid for at any price at which it may be offered by the company, and no one can complain — provided the requirements of the Constitution and statute are complied with; therefore, the sole question for our determination in this case is, where no fraud or deception has been practiced, does the financial plan of organization in question meet the requirements of the provisions of the Constitution and statute, and thereby relieve the appellees of their common law liability to pay for the stock subscribed to by them, up to the par value thereof, until the debts of the company are satisfied?

It is very true, as appellants contend, that the statute, *supra*, enacted pursuant to section 167 of the Constitution, with respect to the liability of subscribers to the capital stock of a corporation chartered under the laws of this State, is in derogation of the

common law, and has to be given a strict construction; but it will readily be observed that the statute, in language plain and unambiguous, provides that subscriptions to the capital stock of any corporation may be paid, not only in money, but in every or any species of property or property rights that could be suggested, including leases, options, contracts, labor or services, etc., and there shall be no individual or personal liability on any subscriber beyond the obligation to comply with such terms as he may have agreed to in his contract of subscription; that any corporation may adopt such plan of financial organization, and may dispose of its stock or bonds for the purposes of its incorporation at such prices, for such consideration, and on such terms and conditions as it sees fit; provided a statement of its financial plan of organization is first filed with the State Corporation Commission, in such form as may be *prescribed* or *permitted* by the commission, setting forth fully and accurately the basis or financial plan upon which such stock or bonds are to be issued; and where such basis or plan includes services or *property* (other than money), received or to be received by the corporation, such statement shall accurately specify and describe, in the manner *prescribed* or *permitted* by the commission, the services and *property*, together with the value at which the same are received, or to be received, and the judgment of the directors as to the value of the services *or property*, *real*, or personal, leases, options, . . . contracts, etc., in the absence of fraud, *shall be conclusive.*

In this case appellees subscribed to $40,000 of the stock (400 shares) of the Exposition Deepwater Pier Corporation, and agreed with themselves, as the incorporators and directors of the company, that said stock be issued to them *fully paid*, in consideration of their turning over to the company "their options, rights, and contracts to acquire land and build a pier near the exposition grounds, and their contracts with various steamboat lines to use said pier exclusively in taking passengers to said grounds, and contracts with said steamboat companies and with the Jamestown Exposition Company to take and pay cash for certain bonds of this company, said rights, options, and contracts being valued at four thousand dollars."

A more indefinite, vague, and unsatisfactory specification and description of the options and contracts agreed to be turned over to the company by appellees in payment for the $40,000 of stock, fully paid, to be issued to them by the company, is hardly to be conceived, but the statement of the financial plan of the organization of the corporation, filed with the Corporation Commission, was in the *form* prescribed by the commission, and was by the commission *permitted* when it received, approved, and ordered the same to be filed and to become a matter of record in the office of the commission.

By the adoption of our present Constitution, and the enactment of statutes pursuant thereto, relating to the issue of stocks and bonds by corporations, the policy of granting charters of incorporation to almost every conceivable business undertaking then in existence, or that might be undertaken within the State, was inaugurated, and, though the policy may be fraught with ever so many possibilities — indeed, probabilities — of fraud and imposition upon individuals, firms, or other corporations dealing with or becoming creditors of a corporation chartered in the State, the courts, in the absence of the charge and proof of fraud in the obtaining of the charter, or the organization of the corporation, or the issuing of its stock, are powerless to prevent or to redress such wrongs or impositions.

This new policy now in vogue in this State has not only in view the granting of a charter to any three or more individuals to conduct, as a corporation, any business that might be conducted by an individual or individuals within the State, but invites the application for such charters, and provides that all persons, firms, partnerships, or other corporations, contracting with the corporation chartered in the State, must look to the records of the State Corporation Commission for information there to be found, or suggested, as to the character, location, and value of the assets of the corporation, and if they fail to look to said records, or fail to make proper inquiry along lines suggested by these records, and sustain a loss or injury in consequence of such neglect of duty, they shall have no remedy in the courts against the stockholders having certificates of fully paid stock for such loss or injury.

One who is advised, or might have been advised, as to the character and value of the assets of a corporation, and extends credit to the corporation, cannot, in the absence of fraud in the organization of the company, or the issuing of its stock or bonds, complain that the assets of the company were not as valuable as he expected them to be, and he has no remedy or right of action against the stockholders of the corporation holding its fully paid stock.

Such is the case before us, and we are of opinion, therefore, that the decree appealed from is right, and it is affirmed.

Affirmed.

COIT v. GOLD AMALGAMATING CO.

119 U.S. 343. 1886.

MR. JUSTICE FIELD delivered the opinion of the court.

The defendant, the North Carolina Gold Amalgamating Company, was incorporated under the laws of North Carolina, on the 30th of January, 1874, for the purpose, among other things, of

working, milling, smelting, reducing, and assaying ores and metals, with the power to purchase such property, real and personal, as might be necessary in its business, and to mortgage or sell the same.

The plaintiff is the holder of a judgment against the company for $5489, recovered in the Court of Common Pleas of Philadelphia, on the 18th of May, 1879, upon its two drafts, one dated June 1st, 1874, and the other August 15th, 1874, each payable four months after its date. Unable to obtain satisfaction of this judgment upon execution, and finding that the company was insolvent, the plaintiff brought this suit to compel the stockholders to pay what he claims to be due and unpaid on the shares of the capital stock held by them, alleging that he had frequently applied to the officers of the company to institute a suit for that purpose, but that under various pretences they refused to take any action in the premises.

By its charter the minimum capital stock was fixed at $100,000, divided into 1000 shares of $100 each, with power to increase it from time to time, by a majority vote of the stockholders, to two million and a half of dollars. The charter provided that the subscription to the capital stock might be paid "in such instalments, in such manner and in such property, real and personal," as a majority of the corporators might determine, and that the stockholders should not be liable for any loss, or damages, or be responsible beyond the assets of the company.

Previously to the charter, the corporators had been engaged in mining operations, conducting their business under the name and title which they took as a corporation. Upon obtaining the charter, the capital stock was paid by the property of the former association, which was estimated to be of the value of $100,000, the shares being divided among the stockholders in proportion to their respective interests in the property. Each stockholder placed his estimate upon the property; and the average estimate amounted to $137,500. This sum they reduced to $100,000, inasmuch as the capital stock was to be of that amount.

The plaintiff contends, and it is the principal basis of his suit, that the valuation thus put upon the property was illegally and fraudulently made at an amount far above its actual value, averring that the property consisted only of a machine for crushing ores, the right to use a patent called the Crosby process, and the charter of the proposed organization; that the articles had no market or actual value, and, therefore, that the capital stock issued thereon was not fully paid, or paid to any substantial extent, and that the holders thereof were still liable to the corporation and its creditors for the unpaid subscription.

If it were proved that actual fraud was committed in the payment of the stock, and that the complainant had given credit to the company from a belief that its stock was fully paid, there would

undoubtedly be substantial ground for the relief asked. But where the charter authorizes capital stock to be paid in property, and the shareholders honestly and in good faith put in property instead of money in payment of their subscriptions, third parties have no ground of complaint. The case is very different from that in which subscriptions to stock are payable in cash, and where only a part of the instalments has been paid. In that case there is still a debt due to the corporation, which, if it become insolvent, may be sequestered in equity by the creditors, as a trust fund liable to the payment of their debts. But where full paid stock is issued for property received, there must be actual fraud in the transaction to enable creditors of the corporation to call the stockholders to account. A gross and obvious overvaluation of property would be strong evidence of fraud. *Boynton* v. *Hatch*, 47 N.Y. 225; *Van Cott* v. *Van Brunt*, 82 N.Y. 535; *Carr* v. *Le Fevre*, 27 Penn. St. 413.

But the allegation of intentional and fraudulent overvaluation of the property is not sustained by the evidence. The patent and the machinery had been used by the corporators in their business, which was continued under the charter. They were immediately serviceable, and therefore had to the company a present value. The corporators may have placed too high an estimate upon the property, but the court below finds that its valuation was honestly and fairly made; and there is only one item, the value of the chartered privileges, which is at all liable to any legal objection. But if that were deducted, the remaining amount would be so near to the aggregate capital, that no implication could be raised against the entire good faith of the parties in the transaction.

Judgment affirmed.

NOTE. — See, *accord*, *Graves* v. *Brooks*, 117 Mich. 424 (but *cf.* *Dieterle* v. *Paint & Enamel Co.*, 143 Mich. 416); *Medler* v. *Hotel Co.*, 6 N.M. 331, 344; *Jones* v. *Whitworth*, 94 Tenn. 602.

PENFIELD *v.* DAWSON TOWN & GAS CO.

57 Neb. 231. 1898.

RYAN, C. This equitable action was brought by certain judgment creditors of the Dawson Town & Gas Company, and by plaintiffs and certain interveners was prosecuted to judgment in the district court of Douglas county against certain stockholders in said corporation. In the petition — in which there were averments of the corporate character of the Dawson Town & Gas Company, the ownership by defendants respectively of certain shares of its capital stock, and the rendition of judgments against said corporation —

there were the following averments: "That said corporation is insolvent and has no property out of which plaintiff can make said judgment; that the authorized capitalized stock of said corporation was $300,000; that said stock was issued to each of the defendants Arthur B. Cooley and J. T. Hoile to the amount and of the par value of $120,000 each, and as payment therefor said defendants fraudulently turned in to said corporation certain real estate situated in the state of Iowa at a false and fictitious value of $205,000; that no payment was ever made on such stock, except said real estate; that said real estate was worth, at the time of said transaction, not to exceed $20,000; that the said defendants and the directors of said corporation knew the value of said real estate, and that said real estate was fraudulently received in payment of said stock; that said real estate was largely incumbered." The holders of stock other than Hoile and Cooley, it was in effect alleged, became such stockholders by assignments from Hoile and Cooley and were therefore liable ratably, as were also Hoile and Cooley, for the difference between the par value of the stock at any time held by them and the actual value of the real property which formed the consideration for the issue of the stock as fully paid up.

In the light of subsequent developments it is not difficult to approve the finding of the district court that the real property, in consideration of which the capital stock of the company was issued, was received by the Dawson Town & Gas Company at a great overvaluation. There was testimony by parties who owned farm lands in the vicinity of the town of Dawson, Iowa, that the lands turned in to the company in payment for its stock was, as farm lands, worth only from $30 to $50 per acre. These witnesses, however, expressly limited their estimates to the value of these lands for farming purposes. On the other hand, the witnesses who testified as to the enhanced value of the property by reason of the shale, the coal, the fire-clay, and the natural gas found beneath its surface placed a much higher valuation upon it, two of them fixing the value of this property at from $400,000 to $500,000. It is true they were interested witnesses, for they were defendants, but the testimony serves to illustrate what considerations might have led them and their associates into honestly making an estimate of the value of the lands turned in, which now seems absurdly excessive. Their testimony was uncontradicted that there were at least four veins of coal, two of which could be profitably worked, on 300 acres of this land; that this coal was overlaid with a stratum, six to thirty feet thick, of shale suitable for the manufacture of paving bricks, and that beneath the coal was a stratum of fire-clay. It was testified that at Dawson alone was there to be found coal on the line of the Chicago, Milwaukee & St. Paul railroad between Omaha and Chicago. On the other tract turned in, which contained 320 acres,

it was testified, without contradiction, that there were three wells which produced natural gas; that the company used this gas for burning bricks; and that its pressure was 120 pounds to the square inch. The town of Dawson, containing about 300 inhabitants, was located on one of these tracts, and it was expected that, with the success of the various manufacturing projects, a considerable portion of the surface could be sold at a high valuation for residence lots. The faith which these parties had in the realization of their hopes is evidenced by their investment in improvements of $40,000, of which $38,000 was in a brick plant and $2,000 was in piping for the gas wells. The valuation by these men was largely speculative, and in their ardor it is possible they may have deceived themselves. In connection with its finding of overvaluation the district court found: "That the defendants acted in good faith and without any attempt to defraud said corporation or its creditors." In other words, the court, upon evidence which justified both conclusions, found that the property at excessive overvaluation was exchanged for stock by the promoters of the corporation, but that this was done in good faith and with no intent to defraud the corporation or its creditors. On the hearing of another case which grew out of these same transactions it was found by the district court that the property turned in for stock had been excessively overvalued, and, in addition, that the exchange was fraudulent in law, and on appeal to this court the judgment of the district court, based upon these findings against the stockholders, was accordingly affirmed. *Gilkie & Anson Co.* v. *Dawson Town & Gas Co.*, 46 Neb. 333. The ultimate inquiry in this case was whether or not the issuance of the stock was fraudulent. The overvaluation was a circumstance tending to establish fraud, and yet it was not of such controlling force that a finding that there was no fraud could not be sustained.

In *Gilkie & Anson Co.* v. *Dawson Town & Gas Co.*, *supra*, it was said: "In this state there were no specific requirements or restrictions in relation to the manner of payment for the stock purchased, and no doubt the land, being such as it was within the province of the company to hold and appropriate for use in its business, could be received in payment for stock. There was no statutory requirement that payment should be in money or the money's worth; but without such an enactment, we think there is a rule of honesty and fair dealing, which should and will be recognized by the courts, which required it. . . . It must be true that where a number of persons have organized themselves as a body corporate and enter the business arena as such and invite and entertain dealings on the faith and credit of a fund, which, increased by gains or decreased by losses, will alone be available for the liquidation or payment of debts, they will be held to fairness and good faith in fulfilling the promise they made to contribute to the fund which they hold out to the

business world as the basis for credit. It is upon the faith of the amount of capital stock, either fully paid in and existing in the form of assets of the corporation, or to be paid in, that the creditor has dealt with and allowed the corporation to incur the liability, or has extended to it the credit, and it seems but just and right to require that payment for stock in other than money be required to be made in the money's worth in good faith and honesty of purpose, and when the circumstances and facts of a sale and purchase of stock disclose that there has been knowingly less than these, that it shall not be upheld against creditors, but the parties be compelled to right what is wrong, to pay and make good that which, through any device or scheme, has been withheld. . . . It may be conceded that when the power exists to accept property in payment for stock the corporation and subscriber may agree upon the value of property to be received in payment for stock in such manner as to be binding upon creditors, if there is no considerable advised and deliberate excessive overvaluations of the property, and that the stockholders will not be liable where the valuation was in good faith, although the property may subsequently prove to be of a less value than that placed upon it, or if there was nothing more than an honest mistake of judgment; but 'a gross and obvious overvaluation of property would be strong evidence of fraud,' in an action by a creditor to enforce a personal liability. *Coit* v. *North Carolina Gold Amalgamating Co.*, 119 U.S. 343, 7 Sup. Ct. Rep. 231. Where property is conveyed to a corporation as payment of a subscription for stock, it is insufficient to satisfy the liability of subscribers to the creditors of the corporation, if there has been a fraudulent overvaluation of the property, — an overvaluation knowingly and advisedly made." In the opinion from which the above quotations have been made it was said that the decisions of the courts are apparently irreconcilable as to the liability of stockholders to creditors on stock issued for property received at an overvaluation. That it may be clear that the position adopted by this court is sustained by a very strong array of adjudications we shall now proceed to demonstrate.

In *Du Pont* v. *Tilden*, 42 Fed. Rep. 87, the syllabus thus correctly reflects the scope of the opinion of Judge BLODGETT: "Where a corporation which is authorized by its charter to buy land and pay for it in full-paid stock, issues such stock in payment for land to an amount greatly in excess of the value of the land, and the stock is sold to a purchaser for value, such purchaser is not liable to the creditors of the corporation on the ground that his stock is not fully paid for, where there was no fraud in the original transaction and the corporation has taken no steps to rescind it."

In the state of New York there was a statute which expressly authorized the trustees of manufacturing corporations, in good faith, to purchase property necessary to their business and issue

stock to the amount of the value thereof in payment therefor and, in event of such purchase in compliance with the law, exempting such trustees from personal liability. This is the condition of the law in this state without statutory provisions, as has already been shown by the quotations from the case of *Gilkie & Anson Co.* v. *Dawson Town & Gas Co.*, *supra.*

In *Douglas* v. *Ireland*, 73 N.Y. 100, it was held that to charge the holder of stock of a manufacturing corporation, issued upon and for the purchase of property, individually for the debts of the company it is not enough to prove that the property was purchased at an overvaluation through a mere mistake or error of judgment on the part of the trustees, and that it must be shown that the purchase was in bad faith and to evade the statute.

In *Boynton* v. *Andrews*, 63 N.Y. 93, it was held in an action to enforce the individual liability of trustees of a manufacturing corporation because of the exchange of stock for property that the question is whether the purchase was in good faith or at a high valuation with a fraudulent intent to evade the statute, and that an honest overvaluation of the property received will not of itself subject the owner of the stock to a personal liability. (See, also, *Schenck* v. *Andrews*, 57 N.Y. 133, to the same effect.)

In *Carr* v. *Le Fevre*, 27 Pa. St. 413, it was held that where a stockholder produced receipts for the amount of the consideration for land by him conveyed to the corporation for a legitimate purchase, it formed the basis for a credit on stock of the corporation purchased, and the sufficiency of the payment was not affected by after-discovered error in the judgment of the company as to the value of the land.

In *Young* v. *Erie Iron Co.*, 65 Mich. 111, MORSE, J., said: "It must be considered as well settled that corporators cannot agree among themselves that property worth only $80,000 shall be treated as worth $422,000 and count at that sum as so much capital stock paid in, and then proceed to make their shares as fully paid up and non-assessable upon such false basis, as such action would be clearly a fraud upon the creditors. But it is equally well settled that such corporators are not responsible for an honest error of judgment, or a mistake in placing a valuation upon property appropriated or used as capital by a manufacturing or mining company. Nor can the fact that a jury or court finds property of the nature of this leasehold, necessarily fluctuating and speculative in value, worthless now, and of but little actual value at the time of its appropriation as capital, be controlling in deciding whether or not such appropriation was fraudulent as against the creditors of the corporation. Such finding will be presumptive evidence of fraud; but if it is shown that those forming the company honestly believed it to be worth the amount specified in the articles, and that their

mistake was one of judgment only, their action cannot be considered fraudulent either in fact or in law. The law imposes no penalty of this kind upon a stockholder or trustee of a company for a mistake or erroneous judgment in the honest and faithful discharge of his duties."

In *Phelan* v. *Hazard*, 5 Dil. [U.S. C.C.] 45, it was held that, unless prohibited by statute, an agreement between the incorporators of a company and the directors, by which the former convey to the company property needed for the purpose of its operations and receive payment therefor in full-paid shares of the stock of the company is, in the absence of fraud, binding upon the parties and such stock is full-paid stock.

In *American Tube & Iron Co.* v. *Hayes*, 30 Atl. Rep. [Pa.] 937, the facts, and the opinion of the supreme court of Pennsylvania thereon, are thus summarized in the syllabus: "(1.) The members of a firm engaged in operating gas wells formed a corporation under the natural gas act of 1885 with a capital stock of $500,000. They agreed with the corporation to transfer the firm's property to it in payment of the $500,000 of stock, and also that they should retain only $175,000 of such stock and turn into the company's treasury the remainder as a working capital. The contracts were performed in good faith. Held, that the stock was paid up, and that the subscribers were not liable to creditors for the amounts subscribed by them. (2.) The facts that the property transferred to the company afterwards proved to be worth much less than $175,000, the amount actually paid for it, and that the parties adopted a clumsy and suspicious method of effecting the transfer, did not render the subscribers liable as for unpaid stock."

In *Bickley* v. *Schlag*, 20 Atl. Rep. [N.J.] 250, it was held by the court of error and appeals of New Jersey that when a corporation, by virtue of its charter, pays for property purchased with its capital stock, such sale cannot be set aside in the absence of fraud, on the ground that the value of such property was not equal to the value of the stock.

In *Clow* v. *Brown*, 31 N.E. Rep. [Ind.] 361, it was held by the supreme court of Indiana that where it appears that the full amount of the capital stock of a corporation was paid to the satisfaction of the contracting parties, such payment can be impeached by a creditor only on the ground of fraud which must be charged in the pleadings.

In *Kelley* v. *Fletcher*, 28 S.W. Rep. [Tenn.] 1099, the views of the supreme court of Tennessee are thus condensed in the syllabus: "A bill by a corporate creditor to enforce liability on the part of the stockholders for the difference between the amounts of their subscriptions and the value of the property conveyed by them to the corporation in payment of the subscriptions must allege an intentional or fraudulent overvaluation of such property."

The necessity of averment of a fraudulent intent, in conjunction with an overvaluation of property exchanged for the capital stock of a corporation, has been recognized and enforced in *Troup* v. *Horbach*, 53 Neb. 795, and our conviction with reference to the correctness of our views therein announced is strengthened by a re-examination of the question, rendered necessary in this case. It is true, generally, that the securing of an advantage by a stockholder to himself by reason of his relations with the corporation with which he is connected subjects his conduct to a species of criticism from which he would be free but for his confidential relation; but, even in the face of the presumptions against a stockholder, he may show that the transaction to which he was a party was *bona fide*. (*Gorder* v. *Plattsmouth Canning Co.*, 36 Neb. 548.) The burden of proof is, doubtless, more strongly devolved upon a stockholder to show good faith with the corporation than it would be if he were a stranger. So it is in transactions between relatives or others sustaining confidential relations in matters involving the rights of creditors, and yet it often happens that such transactions are found valid and the rights of the parties enforceable. The relation of a stockholder to a corporation is no exception to the class of cases involving confidential relations or such that a fraud might be more likely to take place than between strangers. In the case at bar the district court, upon consideration of all the evidence, found that while the property exchanged for capital stock was exchanged at an excessive valuation, yet that this was done in good faith and with no intent to defraud the corporation or its creditors. There was therefore by the last finding eliminated a very essential ingredient to the establishment of a cause of action for a money judgment against the stockholders, and the judgment of the district court is reversed and the cause dismissed.

Reversed and dismissed.

NOTE. — For further authorities that it is not improper to value property at a prospective value, see *Buck* v. *Jones*, 18 Col. App. 250 (dictum); *Finletter* v. *Acetylene Light Co.*, 215 Pa. 86; *Richardson* v. *Mining Co.*, 23 Utah 366 (mining corporation).

LAKE SUPERIOR IRON CO. *v.* DREXEL.

90 N.Y. 87. 1882.

EARL, J. This is an action against the defendant as a stockholder of the Blair Iron and Steel Company to recover the amount of a debt due from that company to the plaintiff, on the ground that the company was not so organized as to protect its stockholders from

individual liability. The company was organized January 6, 1873, under the General Manufacturing Act (Chap. 40 of the Laws of 1848), with a nominal capital of $2,500,000, divided into twenty-five thousand shares of $100 each. The certificate of incorporation was signed by Blair, Struthers, Hall, Smith, and Miller, who were also designated as trustees to manage the affairs of the company for the first year. The objects of the corporation, as stated in the certificate, were "the manufacturing of iron and steel and of such articles as may be used in such manufacture; also the mining and transporting of such minerals as may be used in such manufacture." The five trustees met in New York city on the 20th day of January, and elected Blair president and Smith secretary and treasurer of the company. At that meeting Struthers, one of the trustees, in behalf of the firm of Blair, Foster & Struthers, of which firm he was a member, submitted a written proposition to the company to sell to it certain patents for the manufacture of iron and steel and certain works at Pittsburgh, Pennsylvania, for the price of $2,500,000, and to receive in payment therefor the whole capital stock of the company. The proposition also contained this provision: "Of the twenty-five thousand shares of stock, however, so delivered to us in payment for said patents and property, we agree to place six thousand shares in the hands of Gen. A. S. Diven, as mutual trustee for us, the Blair Iron and Steel Company, and the persons who may become purchasers of said six thousand shares; it being understood that said shares may be sold for $50 per share, one-third thereof to be paid down when the whole of said six thousand shares shall be subscribed for and taken, half of which first payment shall be paid over by said trustee to us when received by him, and the other half to the treasurer for the use of the company, and the whole amount of the remaining two-thirds thereof shall be paid over by him, when received, to the treasurer, for the use of said company. And we agree further to transfer to said A. S. Diven, as trustee, three thousand of the said twenty-five thousand shares, for the future use and benefit of said company, and the whole of the proceeds thereof when sold to be paid and accounted for by him to said company; the trustees to direct the sale of said three thousand shares at such time and on such terms as they may think best for the interest of the company." This proposition was, by a resolution of the trustees, accepted, and a direction was made that the stock be issued to Blair, Foster & Struthers, the certificates thereof to be signed by the president and secretary. On the same day a subscription paper was prepared, to be signed by persons who wished to subscribe for the six thousand shares at fifty per cent of their par value. That paper recited that the whole capital stock of the company had been paid up by the transfer of the patents and the works, and all issued to Blair, Foster & Struthers, who agreed to place in the hands of

Diven, as trustee, nine thousand shares, to be used as working capital for the company, excepting $50,000 of the proceeds thereof, which was first to be paid to them, and that the trustees of the company had ordered the sale of six thousand shares at $50 per share. The defendant subscribed this paper for five hundred shares at $50 per share, and all the six thousand shares were subscribed for by the 12th day of April, 1873, when a formal transfer of the patents and works was made to the company. On that day a certificate of stock for twenty-five thousand shares numbered "Zero" was issued to Blair, Foster & Struthers, and on the same day it was returned and canceled and a certificate numbered "1" for six thousand shares and another numbered "2" for three thousand shares were issued to Diven as trustee, and a certificate for the remaining sixteen thousand shares was issued to Blair, Foster & Struthers.

The proceeds of the six thousand shares subscribed for at $50 per share were paid to the treasurer of the company, and out of the same $50,000 were paid to Blair, Foster & Struthers, according to the terms of their proposition as above set out.

Section 10 of the act of 1848 provides that all the stockholders of every company incorporated under that act "shall be severally individually liable to the creditors of the company in which they are stockholders to an amount equal to the amount of stock held by them, respectively, for all debts and contracts made by such company until the whole amount of capital stock fixed and limited by such company shall have been paid in"; and § 14 provides that "nothing but money shall be considered as payment of any part of the capital stock." In 1853, by the act chapter 333 of that year, the act of 1848 was amended, by providing that the trustees of any company formed under that act "may purchase mines, manufactories, and other property necessary for their business, and issue stock to the amount of the value thereof in payment therefor; and the stock so issued shall be declared and taken to be full stock and not liable to any further calls; neither shall the holders thereof be liable for any further payments under the provisions of the tenth section of the said act." The claim of the plaintiff is that the whole amount of the capital stock was not paid in, and hence that the defendant is liable to it under section 10 above set out; and it contends that it conclusively appears that Blair, Foster & Struthers actually received only sixteen thousand shares of the stock and $50,000 in cash for the property which they transferred to the company.

All the trustees who took from Blair, Foster & Struthers the transfer of the property and caused the stock to be issued to them, were called as witnesses upon the trial, and each testified that he acted in good faith in the transactions and believed the property received was worth the sum of $2,500,000, and the defendant also

gave evidence tending to show that the trustees had good grounds for believing that the property was worth the sum named, and that the stock was issued therefor in good faith.

At the close of the evidence on both sides, plaintiff's counsel moved the court to direct a verdict for the plaintiff upon the ground that "the capital stock of the defendant's corporation being fixed at twenty-five thousand shares, and sixteen thousand shares having been issued in payment for property, and six thousand shares being issued to cash subscribers at fifty per cent of their par, the capital has never been fully paid as required by law." Defendant's counsel moved the court to direct a verdict for the defendant, and to hold that there was nothing in the case which would justify the jury, if the question were submitted to them, in finding that the sale of the property was made in bad faith, or with the intention to evade the requirements of the statute. The court denied both motions and held that the case should be submitted to the jury for them to determine whether the receiving the property and issuing the stock therefor was an honest transaction, consummated in good faith, or whether it was a scheme devised to evade the statute. In charging the jury the court said: "The real question, therefore, is whether the property was placed and taken at a higher valuation with a fraudulent purpose, with the intent of evading the provisions of the statute."

We are of opinion that the court committed no error in the submission of the case to the jury. In *Douglass* v. *Ireland*, 73 N.Y. 100, it was laid down as the law in this State that to charge a holder of stock, issued upon and for the purchase of property, individually for the debts of the company, it is not enough to prove that the property was purchased and paid for at an overvaluation through a mistake or error of judgment on the part of the trustees, but that it must be shown that the purchase at the price agreed upon was in bad faith and to evade the statute; and that all that is necessary to establish the legal fraud and take the stock issued out of the immunity assured to stock honestly issued in pursuance of the act of 1853 is to prove two facts: (1) That the stock issued exceeded in amount the value of the property in exchange for which it was issued; and (2) That the trustees deliberately and with knowledge of the real value of the property overvalued it, and paid in stock for it an amount which they knew was in excess of its actual value. In that case the whole capital stock of the company, three thousand shares, was issued for property to one Horton, and he, in pursuance of an agreement with the company, on or about the same date, transferred back to the company six hundred shares, to be sold to pay the contract price which Horton had agreed to pay for some of the very property transferred to the company for its stock, and also one thousand shares for the purpose of enabling the company to

raise a working capital by the sale of the same. The question of the value of the property received for the stock was submitted to a jury and they found it to be $65,000, and the other questions in the case were decided by the court and it found that the value of the property was so disproportionate to the nominal value of the stock as to take the case out of a sound discretion exercised by the trustees; that the transaction was a fraud upon the law and could not be upheld as a mistake or innocent misunderstanding of the value of the property; that the capital had not been paid in as required by the statute, and that the defendant was therefore liable. The decision of the trial term in that case was upheld, not upon the theory that as matter of law upon the facts proved the capital stock had not been paid in, but upon the findings of fact that it had not been paid in; and whether it was paid in or not was treated as a question of fact which was found against the defendant. Afterward another action was commenced against the same defendant by another plaintiff, and upon substantially the same evidence the jury rendered a verdict in favor of the defendant, and the judgment entered thereon was affirmed at the General Term, upon the ground that the trial judge had substantially followed the case of *Douglass* v. *Ireland* in submitting the case to the jury. *Brockway* v. *Ireland*, 61 How. Pr. 372.

In this case the evidence was very persuasive, that the trustees, in exchanging the stock of the company for the property taken, were endeavoring to evade and circumvent the law, but it was not conclusive. Another view of the evidence was possible, and that is, that the parties believed the property to be worth $2,500,000, for the uses and purposes of the corporation, and that the trustees actually gave the entire stock for it. The title to the stock passed out of the company, and Blair, Foster & Struthers could then do with the stock what they pleased, sell it, give it away, or retransfer a portion of it to the company, in order that the business of the company might be successfully prosecuted, and thus the sixteen thousand shares of stock still held by them rendered more valuable.

When they transferred the nine thousand shares they made a transfer of actual stock which had been paid for, which belonged to them, and which, but for their agreement with the company, they could hold against it. The fact that they were under obligation to devote a portion of the stock received by them to the purposes of creating, through a trustee, a working capital for the company, by which they were to be benefited more than all others, no more altered the real nature of the transaction than if they had agreed to contribute a large sum of money toward the working capital instead of stock. It could not be said, as matter of law, that the property transferred for the stock was not worth the nominal value of the stock, or that the trustees did not believe, and have reasons

to believe, that it was, and it could not be said that they did not issue the whole amount of the stock in payment for the property, because they did, in form, so issue it. Whether the form the transaction took was a mere sham, intended as an evasion of the statute, was a question of fact for the determination of the jury.

It may be said that the statute may thus easily be circumvented and evaded; but the policy of the law will be preserved and enforced if all the questions of fact in such cases be left to the jury under principles laid down in the cases cited.

If right in the views thus far expressed, no error was committed by the trial judge in his charge to the jury and in his refusals to charge as requested by plaintiff's counsel.

The exceptions taken during the progress of the trial to rulings upon questions of evidence have been carefully examined and considered, and it is not believed that any of them point out any error which calls for a reversal of the judgment.

The judgment should be affirmed, with costs.

All concur, except TRACY, J., who does not vote.

Judgment affirmed.

ELYTON LAND CO. *v.* BIRMINGHAM CO.

92 Ala. 407. 1890.

WALKER, J. The bill was filed by the Elyton Land Company as a judgment creditor of the Birmingham Warehouse and Elevator Company, a corporation, and its purpose is to secure the payment of the judgment by the enforcement of the alleged unsatisfied liability of the individual defendants as original subscribers to the stock of the defendant corporation. It is averred that said individual defendants pretend that they have discharged and satisfied their liability as such subscribers, but it is alleged that the transaction whereby it was attempted to discharge that liability is merely colorable and is void, as against the creditors of said corporation, and that said subscribers are liable to pay in money the amount of their said subscriptions or so much thereof as is necessary to satisfy said judgment. The following is the substance of the case stated by the bill: On the 9th day of March, 1887, the Elyton Land Company executed and delivered to the defendant J. A. VanHoose as trustee for the Birmingham Warehouse and Elevator Company, a corporation then in process of organization, its bond of title for two blocks of land near the city of Birmingham, to be paid for at the price of fifty-three thousand dollars. Said VanHoose paid to the Elyton Land Company five thousand dollars on the execution and delivery of the bond for title, by the terms of which it was provided that he was to execute a transfer and conveyance of his rights and

interests thereunder to the Birmingham Warehouse and Elevator Company upon its organization, and that that company should make its nine notes for the balance of the purchase-money to the Elyton Land Company, said notes to be each for $5,333.33, bearing interest from August 20th, 1886, payable respectively at 1, 2, 3, 4, 5, 6, 7, 8, and 9 years from that date. On the 19th day of February, 1887, said VanHoose and the other individual defendants, Johnston, Sage and McLester, filed their petition in the office of the probate judge of Jefferson county for the organization as a corporation of the Birmingham Warehouse and Elevator Company, the capital stock of which was to be fixed at two hundred and fifty thousand dollars, to be divided into twenty-five hundred shares of one hundred dollars each. On the same day a commission was issued to said VanHoose, Johnston, Sage and McLester, constituting them a board of corporators and authorizing them to open books of subscription to the capital stock of the proposed corporation. On the 11th day of March, 1887, said board of corporators over their signatures reported and certified to said probate judge that on the 9th day of March, 1887, they had opened books of subscription to the stock of said proposed corporation and that they had each subscribed for five hundred shares, "subscribed through James A. VanHoose, trustee for the subscribers, and payable in real property near the city of Birmingham, . . . of the money value stated in said subscription of two hundred and fifty thousand, one hundred and thirty-three dollars and thirty-three cents, subject to the unpaid purchase-money due to the Elyton Land Company amounting to fifty thousand one hundred and thirty-three dollars and thirty-three cents, the payment of which is to be assumed by said company, said lands being fully described in the bond for titles of the Elyton Land Company to said James A. VanHoose, trustee, dated March 9th, 1887, which said trustee is to convey to said company in payment of said two thousand shares of stock," and VanHoose, Johnston, Sage and McLester each subscribed for one share payable in money. Said corporators further reported, that on the organization of said company, said VanHoose, Johnston, Sage and McLester were present and each represented in person five hundred and one shares in stock; that each of said persons was elected a director of said corporation, and that the board of directors elected VanHoose as president and McLester as treasurer and secretary of the corporation. It was further reported and certified by the corporators that on the 10th day of March, 1887, after the organization of said company, all the capital stock thereof payable in money was paid to the treasurer and all the property subscribed was delivered to him. The subscriptions were made as reported and certified by the corporators. It was not true at the time of the filing of the bill, or when the subscriptions were made and reported, that said

land was of the money value of two hundred thousand dollars. The price named in said bond for title, fifty-three thousand dollars, was at the time of said subscriptions the full money value of said land when sold on long credit. Said VanHoose, Johnston, Sage and McLester well knew that said land was not worth, nor was it of the money value of, two hundred thousand dollars or anything near that sum. After said subscriptions were made, and after said Birmingham Warehouse and Elevator Company was organized, said VanHoose endorsed to it said bond for title, and said company executed its nine promissory notes as, by the terms of the bond for title, it was provided it should do; and said VanHoose, Johnston, Sage and McLester now claim that the assignment of said bond was a discharge and satisfaction of said subscription of two hundred thousand dollars, which has not been otherwise paid. It is this transaction which the bill alleges is merely colorable and is void as against the creditors of said corporation. Only five thousand dollars has been paid on account of said purchase-money. The Elyton Land Company has recovered judgment against said Birmingham Warehouse & Elevator Company on two of said notes. That judgment remains unsatisfied, and said corporation has no property out of which it could be satisfied by execution.

Each of the individual defendants demurred to the bill upon the following, among other, grounds: 1. That the bill on its face shows that the complainant has no right to the relief therein prayed because it shows that this defendant owes nothing to the Birmingham Warehouse & Elevator Company, either in unpaid subscriptions for stock or otherwise; 2. Because said bill alleges no facts which render this defendant liable personally in any way for the alleged debt mentioned therein as due from said Birmingham Warehouse & Elevator Company to the complainant; and, 3. Because said bill shows that this defendant subscribed for stock in said Birmingham Warehouse & Elevator Company payable in property at a valuation mentioned in said subscription, which property has been delivered and received in full payment for said stock, and said bill fails to show that said property was overvalued unreasonably, intentionally and fraudulently, or that the defendant has made a profit from the stock so subscribed and taken by him. A decree was rendered sustaining the demurrers as to the grounds here mentioned. The appeal is from that decree.

On the averments of the bill it is to be taken as true that the property which was received by the corporation as full payment of the stock subscription was worth only five thousand dollars, the amount which had been paid on the bond for title. It follows that the decree of the Chancery Court involves the assertion of the validity, as against the creditors of the corporation, of the payment of a stock subscription of two hundred thousand dollars by the transfer to the

corporation of property worth only five thousand dollars. In reviewing this determination regard is to be had to certain constitutional and statutory provisions which are to be construed and applied in the light of settled principles governing the relations of stockholders to the corporation of which they are members, and to the creditors thereof. By the Constitution of 1875 it was provided, that "no corporation shall issue stock or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void;" and that "dues from private corporations shall be secured by such means as may be prescribed by law, but in no case shall any stockholder be individually liable otherwise than for the unpaid stock owned by him or her." §§ 6 and 8 of Article XIV of the Constitution. Prior to the adoption of the present Constitution each stockholder in any corporation was liable to the amount of stock held or owned by him, the law imposing a liability not only to the extent that the stock was unpaid, but for an additional sum equal to the amount of such stock. § 3, Art. XIII of the Constitution of 1868; § 1760, Revised Code of 1867; *MacDonnell* v. *Gold Life Ins. Co.*, 85 Ala. 401. Before the creation of this additional liability, the stock and other property of a private corporation was regarded and treated in a court of equity as a trust fund for the payment of the debts of the corporation, and in the event of the insolvency of the corporation, unpaid stock subscriptions could be condemned for the satisfaction of the creditors; and said additional liability was a mere increase of the security for the payment of the corporate debts. *Smith* v. *Huckabee*, 53 Ala. 191. While corporate creditors were secured by this special liability existing in their favor there was no direct constitutional or general statutory prohibition against the abuse of corporate powers by the issue of stock not in good faith representing the value of money, services or property actually contributed to the corporate enterprise; and the general incorporation law then in force contained no requirements as to the mode of subscribing for stock, or as to how the subscription liability should be satisfied. Chapters 3 and 4, Title 2, Part 2, of Code of 1867. The dangers to which corporate creditors were exposed by the absence of such regulations were obviated by the provisions for said additional liability. When those provisions were repealed by the Constitution of 1875, there was an obvious necessity of providing that the trust fund, the remaining security for corporate creditors, should exist as a thing of substance, and that the liability for unpaid stock should not be merely illusory. This necessity was not overlooked. The former legislative policy of securing corporate creditors by making the stockholders liable to them in amounts over and above what they could be called upon to pay on their stock subscriptions gave place to a new policy the aim of which was to afford proper security to persons dealing with corporations by prohibiting

the issue of stock except for value received by the corporation, and by providing definite regulations for the payment of stock subscriptions in money, or in labor or property at its money value. This new policy is evidenced generally by § 6 of Article XIV of the Constitution, quoted above, and particularly as to manufacturing, mining, immigration and industrial business corporations, by § 1805 of the Code of 1876, which provides that "all subscriptions to the capital stock of any company organized or proposed to be organized under the provisions of this article shall be made payable in money, or in labor or property at its money value, to be named in the list of subscription, and in case of a failure to perform the labor, or deliver the property, according to the terms of the subscription, the money value thereof as named in the lists of subscription, shall be paid by the subscribers." These enactments are not for the benefit of corporate creditors alone. The policy evidenced thereby bears upon the relations of corporations to the public and upon the relations of stockholders to each other, to the corporation and to its creditors. This court has not heretofore had occasion to pass upon the question as to the effect of these provisions upon the rights of corporate creditors. The effective operation of the constitutional provision in other connections has been recognized in several cases. In *Fitzpatrick* v. *Dispatch Publishing Co.*, 83 Ala. 604, it was held, at the instance of an objecting stockholder, that under the constitutional and statutory provisions a corporation with a paid-up capital of ten thousand dollars has no authority to double its capital stock and distribute the new stock among its stockholders as a stock dividend, on the mere statement that its capital stock "has been invested in property which has more than doubled in value and is now worth twenty thousand dollars over and above all liabilities;" and an injunction was issued to restrain and enjoin the corporation from carrying into effect a resolution which had been adopted by the stockholders for the issue and distribution of such new stock. In the course of the opinion it was said: "Let us not, by timid interpretation, impair the strength of this bulwark, erected by our constitution-makers against the frauds which have become the reproach of the age we live in." In *Williams* v. *Evans*, 87 Ala. 725, it was held, that relief could not be granted on an executory contract to pay for the transfer of a subscriber's right under a stock subscription whereby it was provided that the corporation to be formed should issue "five dollars of stock for one dollar of subscription." The stock had not been issued when the contract in suit was made. The court said: "A contract which contemplates the violation of a statute, or a constitution, as a mode of executing such contract, is illegal and void. . . . One of the purposes of this clause of the Constitution was to protect the public, as well as stockholders, against spurious and worthless stock by the process of *watering* — in other words, from fraudulently issuing and putting on the

market fictitious corporate stock, which is based on nothing valuable as a consideration for its issue. It is greatly to the interest of the public that the policy of this provision should be enforced." In *Parsons* v. *Joseph*, decided during the present term, and reported in 8 So. Rep. 788, the bill, to which a demurrer was overruled, was filed by a stockholder to secure the cancellation of certain certificates of stock issued to another stockholder, on the ground that the stock so issued was fictitious and that its issue was in violation of the Constitution and the statute law of the State. It was alleged that certain stock was paid for in full by conveying to the company thirty-nine acres of land at an agreed price and valuation of $137 per acre, when the land was not worth more than $25 per acre; that afterwards the capital stock of the company was doubled, and without further consideration than the thirty-nine acres of land, the amount of stock issued therefor was doubled. The contention was in regard to this latter issue of stock. It was alleged that the excessive valuation of the land was made knowingly, willfully, and with the fraudulent intent of having the fictitious stock in question issued in violation of law. On these averments it was held, that the stock in question was issued in violation of § 1662 of the Code of 1886, and of § 6, Art. XIV of the Constitution. It is to be observed that the respective requirements of § 1805 of the Code of 1876 and § 1662 of the Code of 1886 as to how stock subscriptions shall be payable, differ in this, that the former requires the subscriptions to be made payable in money, or in labor or property, at its money value, to be named in the list of subscription; while the latter provides that all subscriptions must be payable in money, but the commissioners may receive subscriptions payable in money, the subscriber having the privilege of discharging the same by the rendition of stipulated necessary services, or the performance of stipulated necessary labor for the corporation, at the reasonable value of such services or labor, or in property, at the reasonable value thereof. It does not seem, however, that the variations in the terms of these two statutes are such, that the fact that the stock subscription was made under the one or the other of them would make any substantial difference in the right of a stockholder to object to the issue of other stock representing property received by the corporation at an excessive and fraudulent overvaluation. In the case last cited it was suggested that stockholders who knowingly and intentionally have subscribed and paid for stock with property upon a fictitious valuation are liable to creditors as stockholders who have not paid up in full for their stock; but the question of such liability was not presented in that case. In *Tutwiler* v. *Tuscaloosa Coal, Iron & Land Co.*, 89 Ala. 391, several questions that might arise from the issue of stock for property taken at a palpably excessive valuation were stated, but not decided. It is plain from this review of the decisions that the constitutional and statutory provisions in question

are treated as effectual to prevent the courts from lending their aid for the enforcement of any contract or obligation the execution of which involves a disregard of those regulations, and that so far as they are appropriate for the protection of stockholders from improper discriminations in accepting payments for stock, those regulations are accorded such effect and operation as to fully accomplish this purpose of their enactment. It can not be doubted that the protection of the interests of corporate creditors is as much within the aim and policy of those regulations as were the objects in behalf of which they have been successfully invoked in this court. In considering the claim of corporate creditors to hold the stockholders of the corporation individually liable on the ground that an attempt by them to satisfy their stock subscriptions by the transfer to the corporation of property at a gross overvaluation was not such payment as the law requires, the fact is not to be lost sight of that the solution of the question is dependent in some measure at least upon constitutional and statutory provisions which the court has already construed as amply effectual to secure the accomplishment of other objects also within the purview of the enactments. And it may be added that a like beneficial operation should be accorded to those provisions when invoked in furtherance of either of their manifest purposes.

[The court reviewed numerous authorities.]

The review of the authorities will not be further extended. Discussions of them may be found in Cook on Stocks and Stockholders, §§ 38 to 47; 1 Morawetz on Corporations, §§ 425 to 429; 2 *Ib.* §§ 825, *et seq.*; 2 Waterman on Corporations, § 188; Taylor on Private Corporations, §§ 545 and 701, *et seq.* Our examination satisfies us that the weight of American authority does not support the statement made by Mr. Cook, in § 47 of his work on Stocks and Stockholders, to the effect that the attempts which have been made, in cases where stock was issued for property taken at an overvaluation, to hold the party receiving such stock liable for its full par value, less the actual value of the property received from him, have been unsuccessful; and that if there has been an overvaluation which is shown to have been fraudulent, then the contract is to be treated like other fraudulent contracts, and is to be adopted *in toto*, or rescinded *in toto* and set aside. We have found no authority at all asserting the exemption of the stockholder from such liability where it appeared that the stock subscription was governed by a statutory regulation at all similar to § 1805 of the Code of 1876 or § 1662 of the Code of 1886. On the other hand, the New York, New Jersey, Maryland and Pennsylvania decisions which have been cited show that the courts in those States, in giving effect to statutory requirements, certainly no more stringent than ours, as to the mode in which stock subscriptions shall be made payable, do not allow attempted payments in property worth greatly less than the amount of the stock issued therefor

to foreclose the just demands of corporate creditors to require that the stock subscriptions be made good in money or in money's worth as contemplated by the statutes. Those courts recognize in such provisions safeguards intended for the protection of persons dealing with corporations as well as for the corporations themselves and the persons associated together therein.

Our general laws afford the amplest and freest facilities for persons desiring to engage in almost any kind of lawful venture to secure by corporate association the advantages of defined and limited responsibility and at the same time the efficient execution of their purposes by means of an artificial being, changes in the membership of which cause no break in the continuity of its action, nor affect its capacity to act, within the scope of its powers, as a natural person. It is plain that such associations, endowed with such powers and privileges, would be a source of danger to persons dealing with them, unless the law required that in their formation suitable provisions be made for a substantial responsibility for such engagements as they may enter into. When legal provisions are found which are appropriately framed to secure the existence of such responsibility it is not permissible so to construe them as to allow a mere formal and illusory compliance therewith to defeat the objects intended to be accomplished. No argument is needed to show that a requirement that the stock of a corporation shall be paid in money, or in labor or property at its money value, inures to the benefit of persons who may become creditors of the corporation, in that it requires the capital stock to be the representative of substantial values and insures the existence of a fund which must be within reach for the satisfaction of debts if the affairs of the corporation are managed as contemplated by the law. It is equally clear that if a stock subscription which is required to be made payable in money, or in labor or property at its money value, and is in fact made payable in property at a designated money valuation, may be satisfied by the transfer of property the value of which is insignificant or merely nominal as compared with the valuation stated, then, so far as this provision of the law looks to the protection of creditors, it might as well have allowed the subscription to be made payable in "chips and whetstones." Except § 6 of Art. XIV of the Constitution and § 1805 of the Code of 1876, there were not, at the time of the formation of the appellee, in reference to the mode of satisfying stock subscriptions, adequate provisions for the protection of creditors of such corporations. Those enactments are appropriate for this purpose. The requirement of § 1805 of the Code of 1876 that "in case of a failure to perform the labor, or deliver the property according to the terms of subscription, the money value thereof as named in the lists of subscription, shall be paid by the subscribers," can not be regarded as providing for a penalty to compel the performance of the labor or

the delivery of the property. The evident meaning is, that in the event of such failure, the corporation shall receive the equivalent, and no more nor less than the equivalent, in money of the labor or the property as the case may be. This clause of the statute is convincing that the statement of the money value of the property in which the subscription is made payable is a material feature of the contract, and that the property delivered must be of a value to correspond with that named in the subscription. As affecting the rights of creditors, the statute is simply a definite requirement as to what shall constitute that trust fund to which persons dealing with the corporation have a right to look. The defendants in this case in making and accepting payments on the stock subscriptions were acting in a fiduciary capacity in reference to that fund. The performance of the contract of subscription to be binding on creditors should have been such as is required in the case of a contract between a trustee and one having knowledge of his trust obligation. In form the stock subscription was such as the statute called for. Under § 2023 of the Code of 1876 and § 8 of Art. XIV of the Constitution, the stockholders are liable only for the unpaid stock owned by them. But the creditors are entitled to demand that the payment on the stock shall be an actual and *bona-fide* discharge of the liability imposed by the contract of subscription. The defendants, in making and accepting payment in property, were bound to exercise their judgment and discretion fairly and honestly directed to secure a substantial compliance with the terms of the contract. In the exercise of that judgment and discretion they are entitled to the benefit of whatever margin there may be for honest differences of opinion in the valuation of the property. But a deliberate and intentional overvaluation of the property is not permissible. The transfer of property known to be worth only $5 000 to pay a stock subscription of $200,000 does not bear the semblance of a compliance with the contract of subscription as to one of the essential terms thereof. The taking of property at a valuation forty times greater than its actual worth, which was known to the parties, shows upon its face the absence of a *bona-fide* exercise of judgment and discretion in making the valuation and an intentional non-compliance with the requirement that the property shall be taken at its money value. The absence of fraudulent motive on the part of a trustee does not give validity to a mere simulated execution of the trust; and an averment of fraud in reference thereto is unnecessary. The parties beneficially interested in the trust are entitled to a substantial compliance with its terms. They are not bound by an act of mere formal compliance which really involves their practical exclusion from the benefits intended to be secured to them. The capital stock of a corporation constitutes the basis of its credit and persons dealing with the corporation have a right to assume that the stock has been actually paid

in or that it may be reached. The transaction whereby payment was attempted to be made, as shown by the averments of the bill in this case, is not binding on creditors because it did not constitute such a payment as was contemplated by the terms of the contract of subscription, and was in effect a palpable evasion of the requirements of the statute. It is, however, contended in the argument for appellees that the appellant through its officers knew of the history of the organization of the appellee corporation and of the mode in which the subscriptions to the stock were to be paid; that in fact it was an active promoter of the whole transaction in advance. It may be that such an unauthorized extinguishment of the subscription liability may not be impeached by one who was actively instrumental in securing the organization of a corporation with a view of making a sale of property to it and did in fact accept benefits in dealing with the corporation with full knowledge of the arrangement by which the stock was proposed to be paid for. Disability to question a wrongful transaction usually attaches to a party who consented thereto or participated therein. *First National Bank* v. *Gustin M. C. Mining Co.*, 6 L.R. An. 676; *Bank of Fort Madison* v. *Alden*, 129 U.S. 372; *Parsons* v. *Joseph*, *supra;* 2 Morawetz on Private Corporations, § 829. But the averments of the bill in this case do not show that the appellant participated in or knew of the mode in which the stock subscription was undertaken to be paid. In the absence of averments upon this subject, it is not to be taken for granted that the appellant, in making the agreement to convey the land to the corporation when formed, contemplated that the stock in the corporation should not be paid for as the law directed; or, that in accepting the notes of the corporation it had such knowledge and such part in the furtherance of the acts connected with the transfer of the bond of title for the stock, that it is to be presumed to have dealt with the corporation on the basis of treating its capital stock as fully paid up. We find nothing in the averments of the bill to preclude appellant from asserting the right of a creditor of a corporation to hold stockholders liable for subscriptions to stock not really paid for. The statements of fact in the bill support the conclusion therein averred, that the transaction by which payment for the stock was attempted to be made was merely colorable; in other words, that it was not really a payment, but had only the outward appearance without the substance of payment. Such being the case, the individual defendants are still liable on their stock subscriptions, to the extent that the attempted payment falls short of a *bona-fide* compliance with the terms of the contract; and the allegations as to excessive overvaluation of the property in question were sufficient under the rules above stated. The Chancery Court erred in sustaining the demurrers.

Reversed and remanded.

NOTE. — See, *accord*, *Lester* v. *Bemis Lumber Co.*, 71 Ark. 379 (property not worth more than fifty per cent of par value of stock); *Allen* v. *Grant*, 122 Ga. 552 (not worth more than ten per cent); *Hobgood* v. *Ehlen*, 141 N.C. 344; *Gates* v. *Tippecanoe Stone Co.*, 57 Ohio 60; *Macbeth* v. *Banfield*, 45 Or. 553 (worth about thirty per cent); *Gogebic Investment Co.* v. *Iron Chief Mining Co.*, 78 Wis. 427. (Cf. *National Bank of Merrill* v. *Illinois Lumber Co.*, 101 Wis. 247.)

DOUGLASS *v.* IRELAND.

73 N.Y. 100. 1878.

APPEAL from judgment of the General Term of the Supreme Court in the fourth judicial department, affirming a judgment in favor of plaintiff, entered upon a verdict.

This action was brought against defendant as a stockholder of "The Black River Iron and Mining Company of New York," a corporation organized under the general manufacturing act (chap. 40, Laws of 1848), under § 10 of said act, to recover certain debts of the corporation, on the ground that his stock was not paid up.

The complaint alleged, in substance, the incorporation of said company with a capital stock of $300,000, with five trustees, one of whom was defendant, and John Horton, another. That at the time of the incorporation Horton had a contract for the purchase of a furnace and mining premises, and one for the purchase of standing timber in the vicinity of the furnace, upon which contracts nothing had been paid, and their fair value did not exceed $20,000; which contracts Horton assigned to said company, receiving therefor the whole of the capital stock; that Horton thereafter divided $200,000 of said stock between himself and the other trustees, and defendant well knowing the facts received over $5,000 thereof; that said stock has never been paid in in any other way, and that no certificate as required by section 11 of said act has been made and recorded.

Upon the trial evidence as to the value of the property was received under objection and exception. The question as to value was, by consent, submitted to the jury; the other questions were decided by the court. The jury found the value of the property to be $65,000. The court found the incorporation of the company with a capital of $300,000, in 3,000 shares, the issuing and transfer of its capital stock in payment for the assignment of the two contracts substantially as alleged in the complaint; also, that Horton, in pursuance of the agreement with the company, on or about the same date, transferred back to the company 600 shares of the capital stock to be sold to pay the contract-price for the furnace property, which was $30,000, and also transferred back 1,000 shares of the capital stock in pursuance

of the same agreement "for the purpose of enabling said company to raise a working capital by the sale of the same;" that defendant, knowing of and participating in the transactions, purchased of the company 250 shares for the sum of $10,000; that the value of the property was so disproportioned to the nominal value of the stock as "to take the case out of a sound discretion exercised by the trustees," and as conclusions of law, he found that the transaction was a fraud upon the law and cannot be upheld as a mistake or innocent misunderstanding of the value of the said property, "that the capital had not been paid in as required by the statute and that defendant was liable."

Further facts appear in the opinion.

ALLEN, J. The question upon which this court divided in *Boynton* v. *Hatch*, 47 N.Y. 225, has been definitely settled by the later decisions of this court as well as the Commission of Appeals. The views I there expressed, and which were agreed to by two of my brethren, have been approved, and it is now settled that to charge a holder of stock, issued upon and for the purchase of property, individually for the debts of the company, it is not enough to prove that the property has been purchased and paid for at an overvaluation through a mere mistake or error of judgment on the part of the trustees, but that it must be shown that the purchase at the price agreed upon was in bad faith and to evade the statute. The transaction may be impeached for fraud, but not for error of judgment or mistaken views of the value of the property, inasmuch as good faith and the exercise of an honest judgment is all that is required. *Schenck* v. *Andrews*, 57 N.Y. 133; *Boynton* v. *Andrews*, 63 id. 93.

The entire capital stock of the "Black River Iron and Mining Company" was issued to Horton, one of the trustees, in consideration of the assignment to the company of two executory contracts; the one for the purchase of a furnace property and premises, and the other of certain woodlands. No part of the capital stock was paid in money, or otherwise than by the assignment of the contracts referred to, and no certificate has been filed as required by section 11 of chapter 40 of the Laws of 1848 that the capital stock has been paid in.

As was said in *Boynton* v. *Hatch*, *supra*, §§ 10 and 14 of the general law of 1848, *supra*, and § 2 of chapter 33 of the Laws of 1853, *supra*, are *in pari materia*, and must be read together as parts of the same general law, and the law is that the entire capital stock of monied and manufacturing corporations organized under the general laws for that purpose must be paid in money, and a certificate thereof filed by the trustees, as required by the law of 1848, and stockholders remain individually liable for the debts of the company until these conditions of the statute are complied with, subject only to the exception engrafted upon the prior general law by the act of 1853, to the

effect that the trustees of such companies may in good faith purchase property necessary to their business, and issue stock to the amount of the value thereof in payment therefor, and the holders of stock thus issued are exempt from liability for the debts of the corporation under section 10 of the prior law. The stock issued in payment for property may be a part or the whole of the capital stock contemplated by the articles of association, or of new stock created for that purpose. *Schenck* v. *Andrews*, 46 N.Y. 589.

The statute, however, only exempts stockholders from liability under § 10 of the original statute in respect of stock issued in good faith, pursuant to the privilege conferred by the supplementary act of 1853; that is, to the amount of the value of property in payment for which it is issued. A deliberate and advised overvaluation of property thus purchased and paid for is a fraud upon the law, and a violation of the condition upon which the exemption of stockholders from liability under the provisions of the original statute is made to depend. It is in direct violation of the policy as well as of the terms of the law which demands payment, either in money or property at its value, of all the capital stock of the company, as a condition of immunity to the stoekholders from liability for debts of the corporation. The payment of an amount for property in excess of its value deprives creditors and the public of the security contemplated by the statute, and thus a fraud is perpetrated as well upon the law as upon creditors. The fraud is consummated by the issue of stock as full paid stock, under the act of 1853, which has not been fully paid for in value by the property for which it is issued, and it does not depend upon any fraudulent intent other than that which is evidenced by the act of knowingly issuing stock for property to an amount in excess of its value. All that is necessary to establish the legal fraud and take the stock issued out of the immunity assured to stock honestly issued in pursuance of the act of 1853 is to prove two facts: 1st. That the stock issued exceeded in amount the value of the property in exchange for which it was issued; and, 2d. That the trustees deliberately, and with knowledge of the real value of the property overvalued it, and paid in stock for it an amount which they knew was in excess of its actual value. The value must be determined in any action in which the question arises upon such evidence as may be given, having respect to the circumstances and the nature of the property, and the *scienter* and guilty action of the trustees may be proved either directly or inferred from circumstances.

The complaint does not specifically *in totidem verbis* charge guilty knowledge of the value of the property, and a fraudulent intent upon the trustees in the purchase from Horton; but it does aver facts, which, if proved, would authorize the inference of every fact necessary to sustain the action. The purchase of property, the value of which did not exceed $20,000, from Horton, one of the trustees, and

the issue of the entire capital stock of the company to the amount of \$300,000 therefor, is alleged, with an averment that \$200,000 of the stock thus issued was divided between Horton and the other trustees, of whom the defendant was one, and that the defendant, well knowing the facts, received upon such division more than \$5,000 of the stock at its par value, and still holds and owns the same. The seller of the property may well be presumed to know its value, and knowledge by the defendant of all the facts stated, including the alleged value of the property, is averred. It is a very significant fact, as alleged, giving character to the transaction, that the seller of the property was willing to and did divide with his co-trustees, the bargainers, two-thirds of the nominal consideration he received for it. This is entirely inconsistent with the idea that the sale was a *bona-fide* sale for the supposed actual value of the property, and without explanation would be conclusive evidence that the purchase by the trustees was not, in the exercise of an honest judgment and the discretion vested in them, at the real or supposed value of the thing purchased; but that under color of a compliance with the provisions of the act of 1853, the purchase of the property and the issue of the stock was a palpable evasion of, and fraud upon, the law. The complaint does, in its substantive facts, make a case entitling the plaintiff to recover, by showing that the stock held and owned by the defendant was not issued for property purchased in good faith for the business of the company, and for the amount of its value, but was issued in fraud of the law, and of those who should afterwards deal with and become creditors of the corporation. The evidence of the value of the property was, therefore, competent, and the objection to its admission was properly overruled.

The facts found by the judge were warranted by the evidence, and sustain the judgment founded thereon. The jury, to whom the question of value was submitted, found the value of the property to be \$65,000, and this was a liberal estimate upon all the evidence. The other questions of fact, and the whole case upon the law, were submitted to the judge as upon a trial by the court, and it is found as a fact that the value of the property was so disproportionate to the nominal value of the stock issued as to take the case out of a sound discretion exercised by the trustees, and as a conclusion of law that the transaction was a fraud upon the law, and not to be upheld as a mistake or innocent misunderstanding of the value of the property, and that the capital stock of the company had not been paid in as contemplated by law.

The property was held by Horton, under executory contracts of purchase, upon which nothing had been paid; the purchase-money being wholly unpaid. The contract-price for the furnace property was \$30,000, and the contract was made out about a year before the sale to the company. The contract for the woodland had been en-

tered into but about five months before the sale to the company, and was for $10,000, to be paid for as the wood should be cut. One-third of the stock issued was immediately retransferred to the company, to be sold by it to raise a "working capital," and enable the company to prosecute its business, and this stock was sold at prices ranging from forty to sixty cents on the dollar of its par value, the defendant buying his at the lowest price named. In this sale of stock by the corporation to the defendant we have the estimate of both buyer and seller — that is, of all the trustees of the company of the value of the property acquired and owned by the company, and represented by the nominal capital of $300,000. By that sale and purchase they fix the value of the property at only $120,000, which is nearly double the value proved upon the trial and found by the jury. The defendant cannot complain if the property is valued at his own price.

The surrender and re-transfer of $100,000 of the stock to the company, without consideration, is some evidence that the $300,000 was not regarded as the value of the property, but that it was so treated with a view to absorb the entire capital stock, and the sale of the stock received by the company at the prices stated was very persuasive evidence of the opinion entertained by the trustees of the value of the property as represented by the stock. The learned judge, before whom the case was tried, was clearly right in his views of the transaction.

All concur, except CHURCH, Ch.J., not voting.

Judgment affirmed.

NOTE. — See *Flour City National Bank* v. *Shire*, 88 N.Y. App. Div. 401; aff'd, 179 N.Y. 587.

In *Coleman* v. *Howe*, 154 Ill. 458, MAGRUDER, J., said (p. 468): "It is held, that stock may be paid for in property as well as in money. 2 Morawetz on Priv. Corp. § 825; 23 Am. & Eng. Enc. of Law, page 794. In the present case, the capital stock was paid for in property alone. Property worth not more than $75,000.00 was conveyed in exchange for capital stock amounting to $300,000.00. There was here an overvaluation of the property which formed the consideration for the issue of the stock. Cases may arise, where stock is issued for property taken at an overvaluation, which will justify the courts in compelling the stockholders to respond to the creditors for the par value of the stock less the actual value of the property taken in exchange for it. Such will not be the case where there is entire good faith in making the valuation. But if the property contributed is not valued in good faith, the shares of stock will not be fully paid up, either in law or fact, by the contribution of such property. A declaration by the corporation that the shares are paid up will not avail against the creditors in case of insolvency. 2 Mora-

wetz on Priv. Corp. § 825. 'The courts have inflexibly enforced the rule, that payment of stock subscriptions is good as against creditors only where payment has been made in money, or what may be fairly considered as money's worth.' *Weatherbee* v. *Baker*, 35 N.J. Eq. 501.

"Some of the cases hold, that overvaluation will not render the stockholder liable for the difference between the actual and accepted values unless there is affirmative proof of fraud *aliunde*. But other cases hold what we regard as the better view, namely, that, where property, whose value is well known or can be easily learned, is taken at an exaggerated estimate, a strong presumption is raised that the valuation is not in good faith and is made for a fraudulent purpose. This presumption will be conclusive unless rebutted by satisfactory evidence explanatory of the apparent fraud. Where the overvaluation is so great that the fraudulent intent appears on its face, and is not explained, the court will hold it to be fraudulent as matter of law."

HERRON CO. v. SHAW.

165 Cal. 668. 1913.

SHAW, J. This is an action against the several defendants, as stockholders of a corporation named Kern River Mining and Power Company to recover a separate judgment against each of them in a sum equal to the amount unpaid upon his subscription for the stock of said company held by him, not exceeding, however, the debt which it is alleged is due from said company to the plaintiff. The court below made its findings and thereupon rendered judgment for the defendants, from which plaintiff appeals.

The case turns upon the question whether or not the stock issued to and held by the several defendants was fully paid up. The authorized capital stock of the Kern River Mining and Power Company was one million dollars, divided into one million shares of one dollar each. Of this, the defendants held in the aggregate 537,635 shares. The complaint alleges that they had paid thereon only ten cents per share. On this point the court found, in effect, that certain persons, not named, owned certain water-rights, mining claims, and mining machinery, that solely in consideration of the transfer thereof by said owners to said company it issued to said owners six hundred and ninety-five thousand of its shares as fully paid nonassessable stock, that nothing further has ever been paid for or on account of said shares, that the market value of said property did not then exceed sixty-nine thousand five hundred dollars, that the board of directors of said corporation did not then believe that the market value of said property was six hundred and ninety-five thousand dollars, but did

believe that it exceeded sixty-nine thousand five hundred dollars and believed that the property purchased could be developed to a value in excess of six hundred and ninety-five thousand dollars, and that said directors "in issuing said stock for said property acted in good faith and in the honest belief that said property could and would be developed so that the said property would have a market value in excess of $695,000." The stock owned by the defendants is a part of the six hundred and ninety-five thousand shares above referred to.

Where the stock of a corporation is issued without being fully paid up, the amount remaining unpaid is, so far as its creditors are concerned, deemed to be money due to the corporation from the stockholders. Such creditor, if the corporation becomes insolvent, may apply, in equity, as plaintiff sought to do here, to have the fund so deemed to be due to the corporation collected and applied upon his debt. The fact that the stock is issued as fully paid up does not estop or bind the creditor, and in such a case, if it is not fully paid up, the creditor may prove the fact and recover enough of the portion that is unpaid to satisfy his debt. No subterfuge or device by which it is made to appear as fully paid up when it is not, will enable the stockholder to avoid this liability. Thus, in *Vermont M. Co.* v. *Declez Granite Co.*, 135 Cal. 579 [87 Am. St. Rep. 143, 56 L.R.A. 728, 67 Pac. 1057], the par value of the stock was one hundred thousand dollars, and it had all been issued to the stockholders as fully paid stock on payment of only twenty thousand dollars. This was done without any intent to defraud creditors. The case holds that the balance of eighty thousand dollars not paid was a fund for the benefit of creditors, which they might collect from the stockholders if the corporation became insolvent. The court said: "The question concerns creditors only. As to them the corporation is presumed to have sought credit based upon its supposed capital of one hundred thousand dollars, actually paid in or due from its stockholders. Public policy requires that the fact whether a particular creditor did trust the corporation on that basis should not be inquired into. The constitution and laws require commercial corporations to have a capital stock, the amount of which shall be stated in the articles, and that this can be had of the corporation only for value." The language of the constitution referred to is that stock can be issued only for "money paid, labor done, or property actually received." Art. XII, § 11.

It is proper to add that in the case just cited it was not claimed that the creditors, at the time of giving credit, knew that the stock had been issued at a cash price less than the par value. The part of the quotation declaring that "public policy requires that the fact whether a particular creditor did trust the corporation on that basis (that the par value had been paid) should not be inquired into," was

not necessary to the decision of the case. The fact that par value had not been paid was admitted. The basis of the doctrine is that credit is given in reliance on the presumption that full par value has been received by the corporation for the stock it has issued as fully paid. We would not here say that this presumption is in all cases conclusive. Cases may arise in which the corporation, at the time of obtaining the credit, made full disclosure to the creditor and the credit has been given with full knowledge by the creditor of the difference between the par value of the stock and the value of the property received for it. If such facts are properly pleaded and proved by the stockholder, we do not mean to declare that it might not be a complete defense to a suit by the creditor to recover such difference. Nothing of the sort appears here, either in the pleadings or findings, and it is unnecessary to consider the question.

The Vermont Marble Company case establishes the rule in this state as to creditor's rights, where the stock is an original issue and is issued as paid up at a price substantially less than the par value, where the price is paid in money. Where it is issued in exchange for labor, services, or specific property, the rule, so far as other stockholders are concerned, seems to be that the transaction is conclusive unless it is fraudulent as to them in purpose or in effect. With regard to creditors we know of no decision in this state. In some jurisdictions, where the value of the property taken in exchange is less than the par value of the stock, it appears to be the rule that creditors can enforce their claims against stockholders to the extent of the difference between the par value of the stock and the actual market value of the property, the value being taken as of the time of the exchange, and the absence of fraud being regarded as immaterial. *Van Cleave* v. *Berkey*, 143 Mo. 109 [42 L.R.A. 593, 44 S.W. 743]; *Cole* v. *Adams*, 19 Tex. Civ. App. 512 [49 S.W. 1052]; *Libby* v. *Tobey*, 82 Me. 404 [19 Atl. 904]; *Wetherbee* v. *Baker*, 35 N.J. Eq. 501. In other states if the exchange is made in good faith, both parties believing that the property is really worth as much as the par value of the stock taken in exchange for it, the transaction is valid as against the creditors; but if there is fraud, or bad faith, or if the property is taken at a valuation known or believed by the parties to be in excess of its real market value, the creditors may impeach the transaction and obtain the benefit of the difference between the par value of the stock and the reasonable value of the property at the time of the exchange. Where there is no fraud or bad faith but the property is knowingly overvalued, it is intimated in some of the cases that the stockholders would be liable only for the difference between the actual value of the property as known to them and the par value of the stock. *Douglass* v. *Ireland*, 73 N.Y. 100; *National Tube W. Co.* v. *Gilfillan*, 124 N.Y. 302 [26 N.E. 538]; *Clayton* v. *Ore Knobe, etc., Co.*, 109 N.C. 389 [14 S.E. 36]; *Elyton Land Co.* v. *Birmingham W. & E. Co.*, 92

Ala. 407 [25 Am. St. Rep. 465, 12 L.R.A. 307, 9 South. 129]; *Sprague* v. *National Bank*, 172 Ill. 166 [64 Am. St. Rep. 17, 42 L.R.A. 606, 50 N.E. 19]; *Young* v. *Erie I. Co.*, 65 Mich. 122 [31 N.W. 814]; *Medler* v. *Albuquerque Hotel Co.*, 6 N. Mex. 345 [28 Pac. 551]; *Allen* v. *Grant*, 122 Ga. 557 [50 S.E. 494]; *Kelly* v. *Clark*, 21 Mont. 291 [69 Am. St. Rep. 668, 42 L.R.A. 621, 53 Pac. 959]; *Gilkie & Anson Co.* v. *Dawson Town & Gas Co.*, 46 Neb. 333 [64 N.W. 978, 1097]; *Osgood* v. *King*, 42 Iowa, 478.

There are also cases where the fact of a known overvaluation was not established or conceded and the court in discussing the effect of evidence of mere overvaluation as proof of fraud, declares that if the real value is substantial the overvaluation is not conclusive proof of fraud and does not overthrow a finding that there was no fraud or fraudulent intent. These cases do not affect the rule to be applied where the parties were at the time aware of the overvaluation. Parties may honestly mistake the value of property and if they do so, proof at the trial that they were mistaken, without proof, direct or circumstantial, that it was not an innocent mistake, will not render the stockholders liable under the rule we are now considering.

There are other decisions in some of the states holding that a creditor cannot rely on the issued capital stock of a corporation as evidence of its solvency, but must inquire as to its assets the same as when he is giving credit to a natural person and, therefore, that an exchange of paid-up stock at less than par value for property does not make the stockholder liable for the difference, unless it is done to defraud creditors. We think the case of *Vermont Marble Co.* v. *Declez Granite Co.*, 135 Cal. 579 [87 Am. St. Rep. 143, 56 L.R.A. 728, 67 Pac. 1057], establishes the opposite rule in this state and hence we do not discuss those decisions.

On principle, we perceive no essential difference between an exchange of full paid stock for property at a known overvaluation and a sale of such stock for money at less than par value, such as was considered in *Vermont M. Co.* v. *Declez.* If, for example, the parties know or believe that certain property is actually worth only twenty thousand dollars, but nevertheless agree to exchange it for corporate stock of the par value of one hundred thousand dollars, to be issued and considered as fully paid up, in what respect is the transaction less injurious to creditors than in a case of sale of full paid stock of the par value of one hundred thousand dollars for twenty thousand dollars in lawful money? Manifestly they are equally injurious and on principle each should be equally susceptible to impeachment in a court of equity for the benefit of the creditors. This being so, it is decisive of the case at bar. The parties here believed that the property was worth less than six hundred and ninety-five thousand dollars, by which we understand a substantial amount less, yet they

exchanged it for six hundred and ninety-five thousand shares of paid-up capital stock at one dollar a share. The numerous cases last cited hold that this is, as to the creditors, constructively fraudulent, that is, it is an evasion of the law which the law visits with the same consequences as if it were intentionally fraudulent.

The further fact found by the court that the directors acted in good faith and honestly believed that the property could and would be developed so that its market value would eventually exceed six hundred and ninety-five thousand dollars, does not relieve or excuse the stockholders from such liability. As appellant's counsel well says, to hold that it would have that effect would be to sanction an arrangement to "throw the risk of the venture from the shoulders of the stockholders to those of the creditors." It is the value of the property in the condition it is in at the time of the exchange, the value as known to the parties and as they honestly believe it to be, that determines the liability, at least where there is no subsequent increase in value nor any intentional fraud. The parties may believe that the property will eventually rise to a value far above that at which it is exchanged, and they may willingly accept the hazard in view of the expected gain, but they have no right to demand that the creditor shall share the risk with them, in effect become their partner with no share in the profits, and lose his recourse on them if their speculation proves a bad one. The case cannot be distinguished in principle from *Vermont M. Co.* v. *Declez Granite Co.*, where stock of the par value of one hundred thousand dollars was sold for less than par in money. The parties may believe, and doubtless frequently do believe, that the money can be invested in property which can be developed so as to make it worth the par value of the stock. Whether the stock is invested in the property by direct exchange, or by first selling it for money and then buying the property from third persons therewith, the effect is the same and the same principle should control. The creditor is presumed to rely on the fact that the company has received, or will receive, full par value for the stock issued. He is not a partner with the stockholder, he cannot participate in the profits of their venture and he should not be required to assume their burden or hazard.

We have alluded to the rule that as to other stockholders the transaction cannot be impeached except for fraud or mistake. *Garretson* v. *Pacific C. Co.*, 146 Cal. 184 [79 Pac. 838], is an example of this class of cases. It is obvious that passages from the opinions in cases involving this rule are not applicable to suits by a creditor and are of no value in the decision of this case.

Respondent cites the decision of the United States Circuit Court in the South Mountain C. M. Co. case (7 Sawy. 30 [5 Fed. 403]; 8 Sawy. 336 [14 Fed. 347]), to the effect that the rule as stated in *Vermont M. Co.* v. *Declez Granite Co.* does not apply to corporations

engaged in mining. The South Mountain case is based on the assumed practice of mining companies to issue full paid stock in exchange for mining claims, wholly undeveloped and of a value unknown and prospective only, at an estimated value far above their actual or known value and fixed by mere guess as to their probable value when developed. This practice, it is said is so universal and so well known that no creditor can be supposed to have been ignorant of it or to have given credit on the belief that the issued stock represented the actual or real value of the assets, and that creditors of such companies must be presumed to have looked to and relied upon the property of the company only, in giving it credit. In the Vermont Company case the court said: "We are not inclined to extend the doctrine of *In re South Mountain Min. Co.*, 7 Sawy. 30 [5 Fed. 403], to this case, even if we were prepared to indorse the principle there announced. This is not such a mining corporation as is there described." This remark is applicable here. The name of the company is Kern River Mining and Power Company. The property transferred by the stock is described as "certain water-rights, mining claims and mining machinery." There is nothing in the record to show whether the company is or was engaged in or intended to engage in mining for precious metals, or whether it was intending to engage in using water to develop power. If the rule of the South Mountain case is to be followed by this court in cases to which it is properly applicable, we think it should be done only where it appears from the record that the company concerned was a mining corporation of the class described in that case and that the property exchanged was of the kind there referred to.

We deem it proper to add that it is not expressly stated anywhere in the record that the defendants were parties to the exchange of the property for the stock mentioned, or that they were aware of the overvaluation when they bought the stock. The argument of both parties is made upon the theory that they either knew of the overvaluation or that they were chargeable to the same extent as if they did know. We have therefore not considered the rule applicable to an innocent purchaser of stock, or to a case where the directors of the corporation knew or believed that the property was worth less than the par value of the stock exchanged for it but the purchaser of the stock honestly believed that the values of the stock and of the property were equal.

The judgment is reversed.

NOTE. — See, *accord, Lea* v. *Iron Belt Mfg. Co.*, 147 Ala. 421.

GILLETT *v.* CHICAGO TITLE & TRUST CO.

230 Ill. 373. 1907.

MR. JUSTICE SCOTT. It is contended by appellants that in accepting certain property in payment of MacKaye's subscription to the capital stock of the Columbian Celebration Company to the amount of $1,999,600, the directors fixed that value upon the property offered in the fair and honest exercise of their judgment as to its worth, and that the stock must therefore be regarded as fully paid and non-assessable, even if the directors erred in their judgment as to its value.

When the board of directors met on May 16, 1892, the principal asset of the corporation was MacKaye's subscription for stock to the amount above mentioned. The law required the directors, in collecting that subscription, to obtain from MacKaye "money or money's worth" to the full amount of the subscription. *Coleman* v. *Howe*, 154 Ill. 458; *Garden City Sand Co.* v. *Crematory Co.*, 205 id. 42. "Money or money's worth" means cash or its equivalent. If the directors saw fit to accept property in lieu of cash they could only take it at its fair cash market value, if it was property which had an ascertainable market value. If it had no ascertainable market value, then the only price at which the directors could purchase it was such price as could be realized by selling it to others for cash.

On the date last mentioned the directors of the corporation entered into a contract with MacKaye, by which, in satisfaction of his liability on his subscription, MacKaye transferred to the corporation the sole and exclusive right to use eleven alleged new, useful and valuable improvements in scenic art; also the right to use and produce a "spectatorio" or play entitled "The Great Discovery," of which it is said MacKaye was the author, in the States of Illinois, Indiana, Michigan, Minnesota, Iowa and Missouri for a period of fifteen years, burdened with a ten per cent royalty reserved to MacKaye. At the time the contract was made no application had been made for a patent on any of the inventions. The description of the inventions contained in the contract is very general in character. With one or two exceptions the descriptions are not such as would enable the reader to identify the invention. They consist usually of the name given by MacKaye to the invention, followed by a statement of the object of the invention. The play, "The Great Discovery," had not been written. At the time MacKaye's subscription was so satisfied the directors were MacKaye, Butterworth, Crosley, White and Edmonds. Crosley did not attend the meeting of May 16, 1892, and MacKaye did not vote upon the proposition in reference to the payment of his subscription by the transfer of the rights above enumerated. Those who voted in favor of accepting the proposition were Butterworth, White and Edmonds. But-

terworth was a co-promoter with MacKaye, and a few days later, in accordance with an arrangement effected prior to May 16, 1892, received from MacKaye a considerable portion of the stock subscribed for by the latter. Edmonds was an assistant to Butterworth, as secretary of the World's Columbian Exposition. White was a clerk in the employ of MacKaye and Butterworth, doing clerical work in connection with the promotion of MacKaye's scheme. So far as the transaction of business affecting the corporation was concerned, White and Edmonds were wholly dominated by MacKaye and Butterworth. Edmonds testified that he "never formed any intelligent conclusion as to the value of the patents," referring to the inventions the right to use which was transferred by the contract; and further: "I did not consider it [the MacKaye proposition which was accepted] in the sense that I was going to put a lot of money in it myself, but I honestly believed on May 16, 1892, that the resolution was for the best interests of the company and was a good proposition for it." White says: "I don't remember making any inquiry, as a member of the board of directors or an officer, into the merits of these inventions."

It will no doubt be agreed that the rights transferred to the corporation by the contract were without market value. It was then the duty of the directors, before accepting the rights transferred by this contract in payment of this large subscription, to ascertain whether those rights had value, and if so, what the value was. The natural and reasonable method to be pursued in determining that question would have been to have applied to men not interested in the promotion of MacKaye's scheme, who were of wide experience in the production of great spectacular plays, for their views in reference to the worth of the rights which MacKaye proposed to transfer. No such investigation was made. No other steps were taken to ascertain the value of the rights MacKaye proposed to transfer, such as would have been taken by directors seeking to deal honestly and fairly with the assets of the corporation. It was the duty of these directors to ascertain the value of these rights precisely as they would have done had they intended to invest money in such rights themselves, and that they did not do. It is no doubt true that if the directors, in the fair, honest and intelligent exercise of their judgment, make a mistake and accept property at a price greater than its real value, such can not be regarded as a fraudulent overvaluation of the property; but that rule only applies where the transaction constitutes a valid contract of bargain and sale, made in good faith on the part of the directors and in the intelligent exercise of fair and honest judgment on their part. There was no such transaction here. The transfer to the corporation was a mere sham. It was, in fact, a sale by MacKaye to MacKaye, and was, in law, a fraud. It was a transfer of the right to use for a period of years, in a limited territory,

an unwritten play and inventions not perfected and not accurately described. The writing of the play and the perfecting of the inventions depended upon MacKaye moving in the matter in the future, and he is conceded to have been practically without property other than these inventions and this play. The play, in fact, never was written. Successful applications were made, after the execution of the contract, for patents upon all the inventions except one. As to that one the application was denied. The evidence leads irresistibly to the conclusion that had the directors on May 16, 1892, after the signing of this contract, sought to have disposed of the rights thereby transferred, they could not, in the world of the drama or elsewhere, have obtained for the rights transferred to the company by that contract anything of value whatever. It follows that MacKaye's stock subscription remained wholly unpaid.

NOTE. — See, *accord*, *State Trust Co.* v. *Turner*, 111 Iowa, 664, 671; *Hastings Malting Co.* v. *Iron Range Co.*, 65 Minn. 28, 34. In the latter case, the court said: "If he knew or ought to have known that he was paying for his stock in property at a material overvaluation, it will not be sufficient for him to show, as a mental operation, that he did not intend to defraud any one."

SEE *v.* HEPPENHEIMER.

69 N.J. Eq. 36. 1905.

PITNEY, V.C. The questions involved in this cause are important, both on account of their intrinsic character and of the amount — over $200,000 — involved. They have been argued on each side by distinguished counsel, in the most able, thorough, exhaustive and lucid manner, so that it is but simple truth to say that if the court, in dealing with the case, shall fall into any error, it will not be due in the least degree to a lack of illuminating instruction from counsel.

The suit is brought by the creditors, represented by the receiver in insolvency, of the Columbia Straw Paper Company, a corporation organized in this state in the month of December, 1892, and thrown into insolvency in May, 1895.

The object of the suit is to hold responsible certain of the stockholders of the company for the debts of the creditors.

The ground on which the defendants are sought to be held is that the stock held by them was issued without any value paid for it, and hence that they occupy the position of subscribers to the capital stock who have not paid their subscriptions, and therefore are liable to the creditors both at common law and under our statute.

First. At common law, on the familiar ground that unpaid sub-

scriptions to capital stock form a trust fund for the benefit of creditors.

Second. And under the fifth section of the act concerning corporations of 1875 (1 Gen. Stat. p. 910), which declares that "where the whole capital of a corporation shall not have been paid in, and the capital paid shall be insufficient to satisfy the claims of its creditors, each stockholder shall be bound to pay on each share held by him the sum necessary to complete the amount of such share as fixed by the charter of the company, or such proportion of that sum as shall be required to satisfy the debts of the company."

The charge of the complainant is that the stock so issued was not issued for cash, but for property purchased at an overvaluation, which overvaluation was arrived at by including in that valuation matters not in any sense property, and that this was done consciously and fraudulently.

The defences of the defendants are not all precisely similar. Those represented by Mr. Corbin claim to stand on a different footing from the others — that is, to have a defence somewhat peculiar to themselves — and they will be so considered.

The stress of the case is found in the defence set up by the defendants represented by Messrs. Lindabury and Marshall.

Counsel for those defendants, whom I shall hereafter call "the defendants," do not contend that the stock held by their clients was issued for cash paid, as required by the fifty-fourth section of the Corporation Act (1 Gen. Stat. p. 917), but they claim that it was issued for property purchased at the value thereof, under the fifty-fifth section of that act, as amended by the act of May 9th, 1889. 1 Gen. Stat. p. 952, § 213. For convenience, I insert here the language of the two sections covering this subject: —

"54. That nothing but money shall be considered as payment of any part of the capital stock of any company organized under this act, except as hereinafter provided for the purchase of property, and no loan of money shall be made to a stockholder or officer therein; and if any such loan shall be made to a stockholder or officer of the company, the officers who shall make it, or who shall assent thereto, shall be jointly and severally liable, to the extent of such loan and interest, for all the debts of the company contracted before the repayment of the sum so loaned."

"213. That the directors of any company incorporated under this act may purchase mines, manufactories or *other property necessary for their business*, or the stock of any company or companies owning, mining, manufacturing or producing materials or other property necessary for their business, and issue stock to the amount of the value thereof in payment therefor, and the stock so issued shall be declared and be taken to be full paid stock and not liable to any further call, neither shall the holder thereof be liable for any further

payments under any of the provisions of this act; and said stock shall have legibly stamped upon the face thereof 'issued for property purchased,' and in all statements and reports of the company to be published this stock shall not be stated or reported as being issued for cash paid into the company, but shall be reported in this respect according to the fact."

These defendants assert that the corporation, after being duly organized, purchased from one Emanuel Stein, of Chicago, thirty-nine different mills or plants, for the manufacture of straw paper, located in several of the western states, at the round sum and price of $5,000,000, for which it issued to Stein $1,000,000 of its bonds, secured by a first mortgage on the properties in question, and $1,000,000 of its preferred stock, and $3,000,000 of its common stock, and that their several holdings of stock are parcels of the stock so issued.

To this the creditors reply that there was no such actual purchase and sale from Stein to the corporation; that Stein was a mere figure-head for himself and one Beard and the defendant Samuel Untermeyer, and that Stein held for himself and the two just named options from the owners of the thirty-nine mills to purchase their mills at an aggregate price stated at $2,250,000, but actually footing up at less than $2,200,000, and that the mills were paid for on that basis, the owners receiving therefor in round figures, and with certain variations not now necessary to be given in detail, $750,000 in cash, $750,000 in preferred stock of the company and $1,500,000 of the common stock at fifty cents on the dollar, which would make $3,000,000. In actually working out the scheme, however, it is asserted and proved that the amount actually paid, counting the common stock at par, was less than $2,800,000, and that the balance of the stock of over $1,000,000 was divided equally between Stein, Beard and the defendant Samuel Untermeyer, without payment therefor.

Further, that the cash so paid was raised by selling the mortgage bonds at par, with two shares of preferred stock and four shares of common stock added as a bonus to each $1,000 bond.

The clients of Messrs. Lindabury and Marshall, as I interpret their argument, do not seriously dispute the accuracy of the statement just made, but they contend that the valuation of $5,000,000 was arrived at after a careful calculation of the quantity of paper, viz., ninety thousand tons, which the thirty-nine mills were able to produce per year, and the greatly increased price which would be realized from its sale by the suppression of the competition theretofore practiced between the several mill-owners. They say that the cost of producing the paper was less than $20 per ton and that its selling price had been reduced by competition to a trifle over $20 per ton, but that by a concentration of the ownership of the mills they found and believed that the price could be easily maintained and the

whole product of ninety thousand tons a year could be marketed at about $28 per ton, which would pay interest on the bonded debt, with one per centum per year for a sinking fund, and a dividend at eight per cent. per year on the preferred stock of $1,000,000, and leave a very large dividend, at least fifteen per cent. each year, for the common stock of the amount mentioned, $3,000,000.

In short, they estimated the value of the property upon a capitalization of the profits expected to be made out of its use by control of the price of its product. So that, taking the aspect of the case most favorable to the defendants, the question which arises out of its ultimate analysis is, whether, under our statute above cited, it is competent and lawful to make up the valuation of the visible property to be purchased for stock issued, by adding to the actual market value, or cost of its reproduction, a sum of money ascertained by the capitalization of the annual profits expected to be realized from a favorable marketing of the product of the company by a suppression of competition. Or, as I believe I asked counsel in argument, can prospective profits, however promising, be considered as *property*, as that word is used in the statute above quoted?

I repeat its language, "the directors of any company incorporated under this act may purchase mines, manufactories or *other property* necessary for their business . . . and issue stock to the amount of the *value thereof* in payment therefor."

There the word "*property*" must evidently be construed by its context which refers to something visible and tangible, and necessary for the business, and the amount of stock to be issued therefor is limited to the *value thereof*, that is, to the value of that *property*.

If the question above put be the true one it seems to me that it answers itself, and adversely to the contention of counsel of defendants.

But the defendants attempt to sustain their valuation in question on two grounds:

First. That the valuation was made in perfectly good faith and without any fraudulent intent; and that fraud is, by the rule to be applied here, a necessary ingredient of overvaluation; and

Second. That the increased valuation in this case may be justified by, and attributed to, the item of "*good will.*"

The reply of counsel for complainant to the point of good faith and absence of fraud is twofold.

First. That these elements have no place in a transaction of this kind where the thing valued is not, properly speaking, property; and

Second. That the good faith and absence of fraud set up by the defendants will not stand the test of close scrutiny, and, further, that the circumstances of the case, given with great detail in the evidence, show that there was no actual appraisement of the property by a competent board of directors such as is contemplated by the statute.

With regard to the defence based on the item of good will, advanced by the defendants, complainant replies, that it is an entire misapplication of the term, and all the law growing out of it, to use it in that connection, and they point out that the conveyances, and the contract preceding them, made by the original owners of the thirty-nine mills, included by express terms the good will of the mills which was included in the original valuation of the mills at $2,250,000, and besides, that the original contracts were in each case accompanied by an undertaking on the part of the vendor not to engage in the business for five years, and that the preliminary contract with Stein also included the good will.

I shall deal with this element of good will at once.

Lord ELDON, in *Cruttwell* v. *Lye* (*1810*), 17 Ves. 335 (at p. 346), said: "The *good will* which has been the subject of sale *is nothing more than the probability that the old customers will resort to the old place.*"

This definition, though often criticised, seems to me to contain the germ of all the more modern and complete definitions.

I am willing to adopt, for present purposes, that written by Judge LACOMBE, of the United States circuit court, and reported in *Washburn* v. *National Wall Paper Co.*, 81 Fed. Rep. 17 (at p. 20), and cited *in extenso* in defendants' printed argument: "Good will has been defined as 'all that good disposition which customers entertain towards the house of business identified by the particular name or firm, and which may induce them to continue giving their custom to it.' There is nothing marvelous or mysterious about it. When an individual, or a firm, or a corporation, has gone on for an unbroken series of years conducting a particular business, and has been so scrupulous in fulfilling every obligation, so careful in maintaining the standard of the goods dealt in, so absolutely honest and fair in all business dealings that customers of the concern have become convinced that their experience in the future will be as satisfactory as it has been in the past, while such customers' good report of their own experience tends continually to bring new customers to the same concern, there has been produced an element of value quite as important — in some cases, perhaps, far more important — than the plant or machinery with which the business is carried on. That it is property is abundantly settled by authority, and, indeed, is not disputed. That in some cases it may be very valuable property is manifest. The individual who has created it by years of hard work and fair business dealing usually experiences no difficulty in finding men willing to pay him for it, if he be willing to sell it to them."

This language was used in a case where the capital stock was issued, as here, for the value of several manufacturing establishments, in which the individual good will of each separate factory was added to the value of its visible property (precisely as would

have been the case here if the stock had been issued for the amount of the sum of the valuations of the several mills with their good will added, to wit, $2,200,000), and the bill was filed by stockholders who received their stock in payment for a mill which they owned and conveyed to the corporation, and they sought by their bill to enjoin the payment of dividends on the stock so issued. It was held that they were estopped from setting up that the property had been overvalued, and, further, that the evidence was insufficient to show such a depreciation in value as would warrant the relief prayed for.

Turning to the present case, we find, as before remarked, that the individual good will of the different properties was included in the individual valuations thereof, and conveyed for the consideration above mentioned to the corporation.

Further, the inference is irresistible that the corporation itself could not possibly, at the time of its organization, have acquired any good will in the proper sense of that word, or, indeed, in any sense of that word. It had made no business friends nor any business reputation. Moreover, an examination in detail of the plan of business laid out and adopted by the promoters of the enterprise, from which they expected to reap such great profits, contemplated a complete destruction of the old good will of the individual establishments.

Mr. Stein had, in fact, no good will to convey with the mills except what he acquired from the individual owners, hence the increase in price cannot be justified on that basis.

It follows that we are driven back to the question first stated — whether prospective and contingent profits of any business, depending, as they always must and do, upon good management and the general course of business of the country, including, always, the element of competition, can be treated as *property* in the sense in which that word is used in the statute above cited.

It seems to me that there can be but one opinion as to the soundness of the notion that profits derived, or to be derived, from the prosecution of any business can be properly taken into account, except to a limited extent, in estimating the value of the mere inanimate instrument which is used in conducting that business. Of course, an instrument which is incapable of producing a product to advantage is of no value. On the other hand, an instrument which produces something of great value at little cost is of itself of value, which, however, is limited by the cost of reproducing the instrument itself.

Of course, an inanimate instrument which has an extraordinary capacity for producing an article of value is usually covered by a patent, and to the actual cost of its physical reproduction must be added the patentee's fee or license, but in the absence of any right arising out of a patent the actual cost of the physical reproduction is the test.

Hence the gross profits to be derived from the carrying on of any ordinary manufacturing business are to be divided — *first*, into a fair rental for the factory, based on the cost of its reproduction; *second*, interest on the working capital; *third*, cost of operating and of administration. The balance, if any, is net profit.

For example, if an ordinary manufacturing business should be unusually successful for a series of years and earn large dividends on the amount of capital invested, no one would think of increasing the valuation of the mill by reason of these profits beyond the cost of its reproduction. The profits were due, in the main, to good management, aided by the general prosperity of the country. Without proper management there might, and probably would, be no profits, and then, on the basis of measuring the value of the mill by the profits of its operations, the mill would be valueless.

The present case is a painful illustration of the utter impossibility of giving the word "property" the construction claimed for it.

The rose-colored future (presently to be stated at length), for this enterprise, created with so much confidence by its promoters, failed entirely in the face of actual experience. . . .

But the defendants say the practice of so valuing property under our statute has been indulged in frequently before, and numerous corporations have been organized and have existed upon such a basis, so that, they argue, the practice has become well nigh crystalized and sanctioned by long usage.

I am sorry to feel constrained to admit that this practice has been frequently indulged in, and, further, that it has brought obloquy upon our state and its legislation. But I am happy to be able to assert, with confidence, that such practice is entirely unwarranted by anything either in our statute or in the decisions of our courts, and whenever it has been indulged in it has involved a clear infringement of, if not a fraud upon, the plain letter and spirit of our legislation.

So far from approving these transactions, our court of errors and appeals has recently, in a case not yet reported, made a decision and rendered an opinion, in which it disapproves of these inflated transactions in the most emphatic and practical manner. I allude to the case of *Volney* v. *Nixon* (since reported, 68 N.J. Eq. 605), the opinion in which I have had opportunity to examine, the headnote of which is as follows: "A contract between two persons that, in exchange for their joint property, one of them shall procure from a corporation of this state an original issue of stock to an amount known by all parties to be in excess of the value of the property, and shall divide the stock thus procured with the other person, is illegal; and the courts of this state will not aid in its enforcement, even though the objectionable feature has been accomplished by the actual issue of the stock."

In the course of the opinion the learned judge (DIXON) remarks:

"It must be remembered that under the laws of New Jersey the stock of the corporation can be originally issued for property purchased only to the amount of what is honestly deemed by the directors the value of the property." Referring to *Donald* v. *American Smelting Co.*, 62 N.J. Eq. (17 Dick.) 729.

"But," say the defendants, "we acted in perfectly good faith; we really believed this property was worth the amount at which it was appraised, and we were guilty of no fraud in that behalf; and to show our good faith we invested therein several hundred thousand dollars ($467,000) in cash, besides $50,000 in services and expenses of the law firm of Guggenheimer & Untermeyer, and their correspondents in Chicago, and have lost it all." And a powerful appeal was made to the court not to subject the defendants to further loss by saddling these enormous debts upon them.

Let us consider the affair from the standpoint of the defendants, and inquire just how and for what they invested their money.

The real estate and good will of the thirty-nine mills footed up in value, for purposes of sale to the corporation, to nearly $2,200,000, and, after allowing for the overvaluation, which we all know that the individual owners of these industrial properties about to be united usually manage to maintain for that purpose, and of which there is some proof in this case, we may reasonably suppose them to be worth $1,500,000, and thus to furnish reasonably good security for $1,000,000 of bonds. Hence it was reasonably safe to invest at par in the bonds to the extent of $1,000,000, secured by a mortgage upon the property.

There was little reason to anticipate the completeness of the final catastrophe.

Now, that investment at par in six per cent. bonds secured by a mortgage on property worth at least one and one-half times the amount of the sum secured, is all that any of the defendants risked.

Not one dollar was invested by any of them beyond the par value of the mortgage bonds of the company. For every $1,000 paid into the company they received a mortgage bond for that amount, and, besides, a bonus of two shares of preferred and four shares of common stock.

It is thus made clear that when the faith of these investors in the value of the property purchased was put to the actual test it went no further than to invest at par in first mortgage six per cent. bonds, secured by property estimated to be worth about twice the amount of the mortgage, to which bonds was added as a bonus, sixty per cent. of stock representing the value of the property above the mortgage.

This transaction is known, in the language employed in these financial transactions, as "getting in on the ground floor," and was so understood by each of the investors. Mr. Heppenheimer, in fact,

uses this very language in his evidence. In answer to a question put by me whether he "did not think Mr. Untermeyer was making you a big present?" he replied, "No, he was not making me any present, but letting me in on the ground floor; that is the way all these corporations have been formed in the State of New Jersey."

No doubt each of these investors really, and therefore in good faith, hoped and expected that the enterprise would prove what they called a success; that is, that the bonds were entirely safe, and so, probably, was the preferred stock, and in like manner it was hoped and expected that the common stock would receive periodical dividends for a period of time long enough at least to enable some, if not all, of it to be marketed, or, to use the apt phrase which has been applied to such transactions, "*to be distributed to*," and later to be "*digested by the public.*"

I am unable to find that the defendants' belief and faith went beyond this.

But I am unwilling to adopt the notion that this sort of good faith is that which is required in order to legalize transactions like this under consideration.

And here we find the real motive and reason which give rise to these inflated values and "watering" of capital stock. It is the desire and intention to sell shares in a property owned by the corporation — for that is what capital stock represents — for more than they are really worth. And therein lies the intrinsically fraudulent character of these transactions.

I feel justified in so characterizing them, since the overvaluation of the property does not at all or in any manner increase its intrinsic or practical value, or in the least degree promote the real prosperity of the enterprise. A single paper mill will turn out just as much product capitalized at $100,000 as $200,000, and its rental value will be practically the same. The earnings and profit due to good management and skillful handling of the product will be the same, and these last do not depend at all upon the product-producing capacity of the mill. Finally, the division of the profits, if any there be, among the stockholders will be on the same basis, and the amount received by each stockholder will be the same, the only difference being in the percentage of the division, and the market values of the shares will finally settle down to the gauge of the dividends earned and declared.

But this straightforward mode of doing business does not satisfy the present-day promoter, whose object in making an overvaluation is twofold.

First. To sell shares at more than their real value, and thereby secure a *profit* immediately in hand. ("Profit" is the word used by Mr. Samuel Untermeyer in his evidence.)

Second. To obtain mercantile credit based on a large capital.

A large number of authorities, in apparent support of inflated values for purposes of capitalization, from different States in the Union, were cited by counsel for defendants.

I shall not stop at this moment to discuss their value in this state and in this connection, because I find the law laid down in this state, under this statute, by the court of errors and appeals in the very recent case, cited by the defendants, of *Donald* v. *American Smelting Co.*, 62 N.J. Eq. (17 Dick.) 729. That case arose under the *act of 1896*, in which the language of the governing section (§ 49) is more liberal than the corresponding section of the act governing the present case, in that it has added the words, "and in the absence of actual fraud in the transaction, the judgment of the directors as to the value of the property purchased shall be conclusive."

That, indeed, was a suit by a stockholder in a corporation, already organized and engaged in its legitimate business, to restrain an issue of stock in payment of additional property to be purchased, but the rule laid down by the learned judge, who spoke for a majority of the court, applies with equal, and I think greater, force to the present case, where creditors are asking for payment of their just debts.

After quoting (p. 731) § 48, and a portion of § 49 of the *act of 1896*, he proceeds: "The meaning of § 48 is not questionable. The money must equal the face value of the stock. The language of § 49 is even more explicit. The corporation may issue stock to the amount of the *value of the property.* The value of the property in the one case just as the value of the money in the other must at least equal the face value of the stock. Such was the view expressed for this court by Mr. Justice Depue in *Wetherbee* v. *Baker*, 35 N.J. Eq. (8 Stew.) 501, and supported by abundance of authority.

"The distinction between the contemplated issue of corporate stock for property and its issue for money lies not in the rule for valuation, but in the fact that different estimates may be formed of the value of property. When such differences are brought before judicial tribunals, the judgment of those who are by law entrusted with the power of issuing stock 'to the amount of the value of the property,' and on whom, therefore, is placed the first duty of valuing the property, must be accorded considerable weight, but it cannot be deemed conclusive when duly subjected to judicial scrutiny. Nor is it necessary that conscious overvaluation or any other form of fraudulent conduct on the part of these primary valuers should be shown to justify judicial interposition. Their honest judgment, if reached *without due examination into the elements of value, or if based in part upon an estimate of matters which really are not property, or if plainly warped by self-interest, may lead to a violation of the statutory rule as surely as would corrupt motive.*

"The cases in this state to which we are referred (citing cases) in support of the proposition that the honest judgment of the man-

agers of a corporation, with respect to matters *intra vires*, cannot be disturbed at the instance of stockholders; all relate to transactions for which the legislature has set up no other criterion than the discretion of those managers. But the original issue of corporate stock is a special function, in the exercise of which the legislature has fixed the standard to be observed, and it is the duty of the courts, so far as their jurisdiction extends, to see that this standard is not violated, either intentionally or unintentionally."

This language, as I understand it, contains the very *ratio decidendi* of the case then under consideration, and is, therefore, binding on me, even if I did not concur in it, which I do most heartily.

The intention of the legislature expressed in these sections in question, in my judgment, manifestly was, that the capital stock of all corporations should *at the start* represent the same value whether paid for in property or money. That result can only be obtained by supposing that the property is to be appraised at its actual cash value, precisely as if a board of directors with the whole capital stock actually paid in cash is dealing at actual "arms'-length" as real purchasers with the owner of property proposed to be purchased as a real vendor, without any interest in the directors to overvalue the property or other interests inconsistent with the real interest of the stockholders as such.

I say "at the start," because we all know that property purchased in good faith for cash is liable afterwards to depreciate in value owing to circumstances not foreseen at the time of its purchase.

After all, it seems to me that the true test, under this statute, as applied to the case here in hand, is this: if the company actually had to its credit in the bank the sum of $5,000,000 would it have been willing to have paid that price in cash for the property in question for the uses and purposes to which it proposed to devote it; would the property be worth that sum in cash to the company?

Any less severe test will, it seems to me, fail to satisfy the letter and spirit of the two sections of the act before recited, which seem to me clearly to require that the shares of capital stock of any company organized under the act in force when this company was organized should be of equal value whether paid for in cash or property purchased.

The learned judge, however, in *Donald* v. *American Smelting Co.*, *supra*, after using the language above quoted, proceeds to express some thoughts, which, so far as I can perceive, are not necessary to the decision of the cause, and so necessarily in the nature, at best, of *obiter dicta*, and therefore not binding upon me.

I venture to suggest that their object was to show the effect of stock once issued coming into the hands of a *bona fide* purchaser. They certainly have no application to the present case in which creditors are suing.

They are, however, relied upon by the defendants and are as follows: —

"When corporate stock has once been issued for property purchased, then the legislature has directed the application of a different rule. In the words of the same § 49, the stock so issued shall be full paid stock, and not liable to any further call, *neither shall the holder thereof be liable for any further payment under the provisions of this act;* and in the absence of actual fraud in the transaction the judgment of the directors as to the value of the property purchased shall be conclusive." (This last clause is not found in the act governing the transaction here in question.)

"Under these provisions, after the property has been purchased and the stock issued therefor, nothing short of *actual fraud in* the transaction can impair the right of the holder to hold his stock as full paid stock, free from further call."

As applied to the case then before the court of errors and appeals, I understand that language as holding that if the stock, the issue of which was sought to be restrained, should be issued with the words "issued for property purchased" printed on the certificate, it would not be competent for the company to deny the validity of the stock and the rights of the holders of the certificates on the ground that the property had been overvalued, unless there was fraud practiced by the vendor on the vendee.

He did not have in mind the case of creditors. (And see the language of Mr. Justice BROWN in *Handley* v. *Stutz*, 139 U.S. 417, at p. 426.)

Moreover, the construction of that language claimed by defendants would result in a practical nullification of the section of the act first above quoted, which declares the liability to creditors of stockholders who have not paid in the amount of their stock, or have paid for it in property at an overvaluation, since it is entirely practicable to purchase the property and issue the stock in a single transaction and before any creditors exist or any judicial interference can be made. In short, the construction claimed would run directly counter to the carefully-prepared opinion of Justice DEPUE, in *Weatherbee* v. *Baker*, 35 N.J. Eq. (8 Stew.) 501 (at p. 511 *et seq.*), relied on by the learned judge in his opinion here in question.

In reading the opinion in *Wetherbee* v. *Baker*, it must be borne in mind that the case there dealt with arose under a statute which apparently contemplated an actual subscription for stock, and there appeared to have been such subscription in that case. But the fifth section of the Corporation Act above quoted, which governs this case, does not contemplate or require any actual subscription to stock, but deals with the stockholder who accepts and holds stock without paying for it in full.

But, taking the language of Justice DIXON, as last above quoted, as the statement of the law, it is quite clear that a conscious over-

valuation is a fraud on the law, in that it is an evasion of its mandate, and is the very sort of fraud mentioned in the statute. It was so treated throughout the opinion of Vice-Chancellor STEVENS in the same case, 61 N.J. Eq. (16 Dick.) 458, and the language of Justice DIXON, just quoted, leaves no room for doubt on this point, where he says: "Nor is it necessary that *conscious overvaluation or any other form of fraudulent conduct* on the part of these primary valuers should be shown to justify judicial interposition. *Their honest judgment, if reached without due examination into the elements of value, or if based in part upon an estimate of matters which really are not property, or if plainly warped by self-interest, may lead to a violation of the statutory rule as surely as would corrupt motive.*"

If, then, the promoters of this enterprise and the directors, who assisted them in adopting the valuation in question, consciously included in their valuation thereof "an estimate of matters which really are not property," which I have shown they did, then there was a conscious overvaluation of the property which amounts to a fraud on the act.

A strong appeal was made to the court in the argument of defendants' counsel, based on the fact that these defendants had lost between $300,000 and $400,000 of cash, and that no further loss ought to be thrown upon them. With regard to that plea I have this to say: Men of business, who transact their business under the shield of a corporate existence, have the great and peculiar advantage over those trading as individuals of avoiding personal pecuniary liability. If the enterprise is prosperous, they make and enjoy its gain. If, on the other hand, it is not prosperous, they lose only their original investment, which may be a part only of their individual fortunes, and any loss beyond that investment falls on the unfortunate creditors. This involves apparent, if not real, unfairness in trade. Be that as it may, under these conditions, surely the investors in the stock of trading corporations ought not to complain or ask any sympathy if the courts of the country hold them to a strict compliance with the terms of the law under which they claim immunity from pecuniary responsibility.

They ought not to complain if the creditors of the corporation shall demand that the original statement of their capital stock shall be made good by those persons who accept it from the company.

LANTZ *v.* MOELLER.

76 Wash. 429. 1913.

MAIN, J. The respondents contend that, when the stock is paid for by the transfer of property, the liquidation of the liability on the

subscription contract is complete, even though there may be a material discrepancy between the par value of the stock and the value of the property transferred in payment thereof, unless there is fraud in the transaction either actual or constructive. According to this contention, it would be immaterial whether or not the value of the property transferred to the corporation in payment of the subscription was substantially equivalent to the par value of the stock. It must be admitted that the expressions of this court, from time to time, have not been harmonious upon this question. The rule contended for by the respondents appears to be supported in the cases of *Turner* v. *Bailey*, 12 Wash. 634, 42 Pac. 115; *Kroenert* v. *Johnston*, 19 Wash. 96, 52 Pac. 605, and possibly some others. The opposite doctrine, that the stock of a corporation is a trust fund for the benefit of its creditors and that, when the rights of creditors are involved, the stock subscribed for must be paid in money or money's worth, is upheld in the following cases: *Adamant Mfg. Co.* v. *Wallace*, 16 Wash. 614, 48 Pac. 415; *Dunlap* v. *Rauch*, 24 Wash. 620, 64 Pac. 807; *Davies* v. *Ball*, 64 Wash. 292, 116 Pac. 833. In the Adamant case, *supra*, this court in an opinion written by the late Chief Justice DUNBAR, said: —

"The doctrine that the stock of a corporation is a trust fund for the benefit of creditors is one which is founded in equity and fair dealing, and in any event has become so well established in this country that it can no longer be gainsaid. This doctrine was announced by Chancellor KENT, as early as 1824, in *Wood* v. *Dummer*, 3 Mason, 309, and since that time has become the established law of this country and is termed the 'American doctrine,' although, as shown in the case above referred to, the same doctrine had long been established in England; and so universally has this doctrine been accepted, in America especially, that the citation of authorities seems a work of supererogation. We will, however, quote from 2 Morawetz on Private Corporations, § 820, the rule which is announced as follows: 'Debts due a corporation are equitable assets, and may be reached by creditors through the aid of a court of chancery, if the legal assets which can be reached by execution prove insufficient. The liability of the shareholders to contribute the amount of their shares as capital is treated in equity as assets, like other legal claims belonging to the corporation. This liability, together with the capital actually contributed, constitutes the trust fund which in equity is deemed pledged for the payment of the corporate debts.' This being true, then it must necessarily follow, for the protection of creditors who dealt with these corporations, that the stock subscribed for must be paid in cash or in property of an equivalent value. In other words, the corporation must be in the actual condition which it represents itself to be in financially. If it were allowed to hold itself out as having a capital stock of $100,000, when in reality the capital stock,

which is and must be under the theory of the law, assets in the hands of the corporation, is worth only one-half that amount, the corporation is to that extent doing business under false colors, and is obtaining credit upon the faith of an asserted estate which is purely fictitious."

We think the rule as laid down in the Adamant case is not only legally but ethically sound, and all the decisions of this court which are not in harmony with the views therein expressed are overruled.

NOTE. — See, *accord*, *Kentucky Mutual Co.* v. *Schaefer*, 120 Ky. 227; *Dilzell Engineering Co.* v. *Lehmann*, 120 La. 273; *Berry* v. *Rood*, 168 Mo. 316; *Cole* v. *Adams*, 19 Tex. Civ. App. 507.

HOSPES *v.* NORTHWESTERN MFG. & CAR CO.

48 Minn. 174. 1892.

MITCHELL, J. The principal question in the case is whether the complaint states facts showing that the thresher company, as creditor, is entitled to the relief prayed for; or, in other words, states a cause of action. Briefly stated, the allegations of the complaint are that on May 10, 1882, Seymour, Sabin & Co. owned property of the value of several million dollars, and a business then supposed to be profitable. That, in order to continue and enlarge this business, the parties interested in Seymour, Sabin & Co., with others, organized the car company, to which was sold the greater part of the assets of Seymour, Sabin & Co. at a valuation of $2,267,000, in payment of which there were issued to Seymour, Sabin & Co. shares of the preferred stock of the car company of the par value of $2,267,000, it being then and there agreed by both parties that this stock was in full payment of the property thus purchased. It is further alleged that the stockholders of Seymour, Sabin & Co., and the other persons who had agreed to become stockholders in the car company, were then desirous of issuing to themselves, and obtaining for their own benefit, a large amount of common stock of the car company, "without paying therefor, and without incurring any liability thereon or to pay therefor;" and for that purpose, and "in order to evade and set at naught the laws of this state," they caused Seymour, Sabin & Co. to subscribe for and agree to take common stock of the car company of the par value of $1,500,000. That Seymour, Sabin & Co. thereupon subscribed for that amount of the common stock, but never paid therefor any consideration whatever, either in money or property. That thereafter these persons caused this stock to be issued to D. M. Sabin as trustee, to be by him distributed among them. That it was so distributed without receipt by him or the car

company, from any one, of any consideration whatever, but was given by the car company and received by these parties entirely "gratuitously." The car company was, at this time, free from debt, but afterwards became indebted to various persons for about $3,000,000. The thresher company, incorporated after the insolvency and receivership of the car company, for the purpose of securing possession of its assets, property, and business, and therewith engaging in and continuing the same kind of manufacturing, prior to October 27, 1887, purchased and became the owner of unsecured claims against the car company, "*bona fide*, and for a valuable consideration," to the aggregate amount of $1,703,000. As creditor, standing on the purchase of these debts, which were contracted after the issue of this "bonus" stock, the thresher company files this complaint to recover the par value of the stock as never having been paid for. The complaint does not allege what the consideration of these debts was, nor to whom originally owing, nor what the intervener paid for them, nor whether any of the original creditors trusted the car company on the faith of the bonus stock having been paid for. Neither does it allege that either the thresher company or its assignors were ignorant of the bonus issue of stock, nor that they or any of them were deceived or damaged in fact by such issue, nor that the bonus stock was of any value. Neither is there any traversable allegation of any actual fraud or intent to deceive or injure creditors. A desire to get something without paying for it, and actually getting it, is not fraudulent or unlawful if the donor consents, and no one else is injured by it; and the general allegation that it was done "in order to evade and set at naught the laws of the state" of itself amounts to nothing but a mere conclusion of law. As a creditors' bill, in the ordinary sense, the complaint is manifestly insufficient. The thresher company, however, plants itself upon the so-called "trust-fund" doctrine, that the capital stock of a corporation is a trust fund for the payment of its debts; its contention being that such a "bonus" issue of stock creates, in case of the subsequent insolvency of the corporation, a liability on part of the stockholder in favor of creditors to pay for it, notwithstanding his contract with the corporation to the contrary.

This "trust-fund" doctrine, commonly called the "American doctrine," has given rise to much confusion of ideas as to its real meaning, and much conflict of decision in its application. To such an extent has this been the case that many have questioned the accuracy of the phrase, as well as doubted the necessity or expediency of inventing any such doctrine. While a convenient phrase to express a certain general idea, it is not sufficiently precise or accurate to constitute a safe foundation upon which to build a system of legal rules. The doctrine was invented by Justice STORY in *Wood* v. *Dummer,* 3 Mason, 308, which called for no such invention, the fact

in that case being that a bank divided up two thirds of its capital among its stockholders without providing funds sufficient to pay its outstanding bill holders. Upon old and familiar principles this was a fraud on creditors. Evidently all that the eminent jurist meant by the doctrine was that corporate property must be first appropriated to the payment of the debts of the company before there can be any distribution of it among stockholders, — a proposition that is sound upon the plainest principles of common honesty. In *Fogg* v. *Blair*, 133 U.S. 534, 541 (10 Sup. Ct. Rep. 338), it is said that this is all the doctrine means. The expression used in *Wood* v. *Dummer* has, however, been taken up as a new discovery, which furnished a solution of every question on the subject. The phrase that "the capital of a corporation constitutes a trust fund for the benefit of creditors" is misleading. Corporate property is not held in trust, in any proper sense of the term. A trust implies two estates or interests, — one equitable and one legal; one person, as trustee, holding the legal title, while another, as the *cestui que trust*, has the beneficial interest. Absolute control and power of disposition are inconsistent with the idea of a trust. The capital of a corporation is its property. It has the whole beneficial interest in it, as well as the legal title. It may use the income and profits of it, and sell and dispose of it, the same as a natural person. It is a trustee for its creditors in the same sense and to the same extent as a natural person, but no further. This is well illustrated and clearly announced in the case of *Graham* v. *La Crosse & M. R. Co.*, 102 U.S. 148. That was a creditors' suit to reach a piece of real estate on the ground that it had been conveyed by the corporation fraudulently for a wholly inadequate consideration. The trust-fund doctrine was invoked by a subsequent creditor, and it was claimed that, as the trust had been violated, the deed should be set aside. If the premise was correct that the corporation held it in trust for creditors, the conclusion was inevitable; but the court denied the premise, saying that a corporation is in law as distinct a being as an individual is, and is entitled to hold property (if not contrary to its charter) as absolutely as an individual can hold it. Its estate is the same, its interest is the same, its possession is the same; and that there is no reason why the disposal by a corporation of any of its property should be questioned by subsequent creditors any more than a like disposal by an individual; that the same principles of law apply to each. That the phrase that "the capital of a corporation is a trust fund for the payment of its creditors" is misleading, if not inaccurate, is illustrated by the character of the actions that are frequently mistakenly instituted on the strength of it. For example, in the case of *Wabash, etc., R. Co.* v. *Ham*, 114 U.S. 587 (5 Sup. Ct. Rep. 1081), two roads had been consolidated, the new company acquiring the property of the old ones. A creditor of one of the old companies, on the strength of the "trust-fund"

doctrine, claimed a lien on its property in the hands of the new corporation. If this property was impressed with a trust in favor of creditors in the hands of the old company, it would logically follow that it would continue so in the hands of the new one. But the court denied the relief, and, in giving its construction of the "trust-fund" doctrine, said: "The property of a corporation is doubtless a trust fund for the payment of its debts in the sense that when the corporation is lawfully dissolved, and all its business wound up, or when it is insolvent, all its creditors are entitled in equity to have their debts paid out of the corporate property before any distribution thereof among the stockholders. It is also true, in the case of a corporation, as in that of a natural person, that any conveyance of the property of the debtor without authority of law and in fraud of existing creditors is void." This is probably what is meant when it is said in some cases, as in *Clark* v. *Bever*, 139 U.S. 96, 110 (11 Sup. Ct. Rep. 468), that the capital of a corporation is a trust fund *sub modo.* If so, no one will dispute it. But it means very little, for the same thing could be truthfully said of the property of an individual or a partnership. And obviously it would make no difference whether the disposition of the corporate property is to a stranger or to a stockholder, except that, of course, the latter could not be an innocent purchaser.

There is also much confusion in regard to what the "trust-fund" doctrine applies. Some cases seem to hold that unpaid subscribed capital is a trust fund, while other assets are not, — that is, so long as the subscription is unpaid, it is held in trust by the corporation, but, when once paid in, it ceases to be a trust fund; while other cases hold that, paid or unpaid, it is all a trust fund. The first seems to be the rule laid down in *Sawyer* v. *Hoag*, 17 Wall. 610, in which the "trust-fund" doctrine was first squarely announced by that court with all the vigor and force characteristic of the great jurist who wrote the opinion. In that case a stockholder in an insurance company had given his note, as the court found the fact to be, for 85 per cent. of his subscription to the stock of the company. After the company had become bankrupt, and the stockholder knew the fact, he bought up a claim against the company for one third its face, and in a suit by the assignee in bankruptcy on his note set up this claim as an offset. That this would have been a fraud on the bankrupt act, and at least a moral fraud on policy holders, is quite apparent without invoking the "trust-fund" doctrine; and, if the note for unpaid stock was a trust fund, there could have been no offset, whether the company was solvent or insolvent. In the opinion it is said that, if the subscription had been paid by the note or otherwise, the note ceased thereby to be a trust fund to which creditors can look, and becomes ordinary assets, with which directors may deal as they choose. But in *Upton* v. *Tribilcock,* 91 U.S. 45, it is stated: "The capital paid in

and promised to be paid in is a fund which the trustees cannot squander or give away." While in *Sanger* v. *Upton*, Id. 56, it is said: "When debts are incurred a contract arises with the creditors that it [the capital] shall not be withdrawn or applied otherwise than upon their demands until such demands are satisfied." And in the same connection it is distinctly stated that there is no difference between assets paid in and subscriptions; that "unpaid stock is as much a part of this pledge and as much a part of the assets of the company as the cash which has been paid in upon it. Creditors have the same right to look to it as to anything else, and the same right to insist upon its payment as upon the payment of any other debt due to the company. *As regards creditors, there is no distinction between such a demand and any other asset which may form a part of the property and effects of the corporation.*" This language is quoted and approved in *County of Morgan* v. *Allen*, 103 U.S. 498, 508. It would seem clear that this is the correct statement of the law. The capital (not the mere share certificates) means all the assets, however invested. If a subscriber gives his note for his stock, that note is no more and no less a trust fund than the money would have been if he had paid cash down. Capital cannot change from a trust to not a trust by a mere change of form. It is either all a trust or all not a trust, and the "trust-fund" rule, whatever that be, must apply to all alike, and in the same way. If the assets of a corporation are given back to stockholders, the result is the same as if the shares had been issued wholly or partly as a bonus. The latter is merely a short cut to the same result. So with dividends paid out of the capital, voluntary conveyances, stock paid in overvalued property; all are forms of one and the same thing, all reaching the same result (a disposition of corporate assets), which may or may not be a fraud on creditors, depending on circumstances. This much being once settled, the solution of the question when a subsequent creditor can insist on payment of stock issued as paid up, but not in fact paid for, or not paid for at par, becomes, as we shall presently see, comparatively simple.

Another proposition which we think must be sound is that creditors cannot recover on the ground of contract when the corporation could not. Their right to recover in such cases must rest on the ground that the acts of the stockholders with reference to the corporate capital constitutes a fraud on their rights. We have here a case where the contract between the corporation and the takers of the shares was specific that the shares should not be paid for. Therefore, unlike many of the cases cited, there is no ground for implying a promise to pay for them. The parties have explicitly agreed that there shall be no such implication, by agreeing that the stock shall not be paid for. In such a case the creditors undoubtedly may have rights superior to the corporation, but these rights cannot rest on the implication that the shareholder agreed to do something directly

contrary to his real agreement, but must be based on tort or fraud, actual or presumed. In England, since the act of 1867, there is an implied contract created by statute that "every share in any company shall be deemed and be taken to have been issued and to be held subject to the payment of the whole amount thereof in cash." This statutory contract makes every contrary contract void. Such a statute would be entirely just to all, for every one would be advised of its provisions, and could conduct himself accordingly. And in view of the fact that "watered" and "bonus" stock is one of the greatest abuses connected with the management of modern corporations, such a law might, on grounds of public policy, be very desirable. But this is a matter for the legislature, and not for the courts. We have no such statute; and, even if the law of 1873, under which the car company was organized, impliedly forbids the issue of stock not paid for, the result might be that such issue would be void as *ultra vires*, and might be canceled, but such a prohibition would not of itself be sufficient to create an implied contract, contrary to the actual one, that the holder should pay for his stock.

It is well settled that an equity in favor of a creditor does not arise absolutely and in every case to have the holder of "bonus" stock pay for it contrary to his actual contract with the corporation. Thus no such equity exists in favor of one whose debt was contracted prior to the issue, since he could not have trusted the company upon the faith of such stock. *First Nat. Bank* v. *Gustin, etc., Mining Co.*, 42 Minn. 327 (44 N.W. Rep. 198); *Coit* v. *Gold Amalgamating Co.*, 119 U.S. 343 (7 Sup. Ct. Rep. 231); *Handley* v. *Stutz*, 139 U.S. 417, 435 (11 Sup. Ct. Rep. 530). It does not exist in favor of a subsequent creditor who has dealt with the corporation with full knowledge of the arrangement by which the "bonus" stock was issued, for a man cannot be defrauded by that which he knows when he acts. *First Nat. Bank* v. *Gustin, etc., Mining Co., supra.* It has also been held not to exist where stock has been issued and turned out at its full market value to pay corporate debts. *Clark* v. *Bever, supra.* The same has been held to be the case where an active corporation, whose original capital has been impaired, for the purpose of recuperating itself, issues new stock, and sells it on the market for the best price obtainable, but for less than par (*Handley* v. *Stutz, supra*); although it is difficult to perceive, in the absence of a statute authorizing such a thing (of which every one dealing with the corporations is bound to take notice), any difference between the original stock of a new corporation and additional stock issued by a "going concern." It is difficult, if not impossible, to explain or reconcile these cases upon the "trust-fund" doctrine, or, in the light of them, to predicate the liability of the stockholder upon that doctrine. But by putting it upon the ground of fraud, and applying the old and familiar rules of law on that subject to the peculiar nature of a corporation and the re-

lation which its stockholders bear to it and to the public, we have at once rational and logical ground on which to stand. The capital of a corporation is the basis of its credit. It is a substitute for the individual liability of those who own its stock. People deal with it and give it credit on the faith of it. They have a right to assume that it has paid-in capital to the amount which it represents itself as having; and if they give it credit on the faith of that representation, and if the representation is false, it is a fraud upon them; and, in case the corporation becomes insolvent, the law, upon the plainest principles of common justice, says to the delinquent stockholder, "Make that representation good by paying for your stock." It certainly cannot require the invention of any new doctrine in order to enforce so familiar a rule of equity. It is the misrepresentation of fact in stating the amount of capital to be greater than it really is that is the true basis of the liability of the stockholder in such cases; and it follows that it is only those creditors who have relied, or who can fairly be presumed to have relied, upon the professed amount of capital, in whose favor the law will recognize and enforce an equity against the holders of "bonus" stock. This furnishes a rational and uniform rule, to which familiar principles are easily applied, and which frees the subject from many of the difficulties and apparent inconsistencies into which the "trust-fund" doctrine has involved it; and we think that, even when the trust-fund doctrine has been invoked, the decision in almost every well-considered case is readily referable to such a rule.

It is urged, however, that, if fraud be the basis of the stockholders' liability in such cases, the creditor should affirmatively allege that he believed that the bonus stock had been paid for, and represented so much actual capital, and that he gave credit to the corporation on the faith of it; and it is also argued that, while there may be a presumption to that effect in the case of a subsequent creditor, this is a mere presumption of fact, and that in pleadings no presumptions of fact are indulged in. This position is very plausible, and at first sight would seem to have much force; but we think it is unsound. Certainly any such rule of pleading or proof would work very inequitably in practice. Inasmuch as the capital of a corporation is the basis of its credit, its financial standing and reputation in the community has its source in, and is founded upon, the amount of its professed and supposed capital, and every one who deals with it does so upon the faith of that standing and reputation, although, as a matter of fact, he may have no personal knowledge of the amount of its professed capital, and in a majority of cases knows nothing about the shares of stock held by any particular stockholder, or, if so, what was paid for them. Hence, in a suit by such creditor against the holders of "bonus" stock, he could not truthfully allege, and could not affirmatively prove, that he believed that the defendants' stock

had been paid for, and that he gave the corporation credit on the faith of it, although, as a matter of fact, he actually gave the credit on the faith of the financial standing of the corporation, which was based upon its apparent and professed amount of capital. The misrepresentation as to the amount of capital would operate as a fraud on such a creditor as fully and effectually as if he had personal knowledge of the existence of the defendants' stock, and believed it to have been paid for when he gave the credit. For this reason, among others, we think that all that it is necessary to allege or prove in that regard is that the plaintiff is a subsequent creditor; and that, if the fact was that he dealt with the corporation with knowledge of the arrangement by which the "bonus" stock was issued, this is a matter of defense. *Gogebic Inv. Co.* v. *Iron Chief Min. Co.*, 78 Wis. 427 (47 N.W. Rep. 726). Counsel cites *Fogg* v. *Blair*, *supra*, to the proposition that the complaint should have stated that this stock had some value; but that case is not in point, for the plaintiff there was a prior creditor; and, as his debt could not have been contracted on the faith of stock not then issued, he could only maintain his action, if at all, by alleging that the corporation parted with something of value.

In one respect, however, we think the complaint is clearly insufficient. The thresher company is here asking the interposition of the the court to aid in enforcing an equity in favor of creditors against the stockholders by declaring them liable to pay for this stock contrary to their actual contract with the corporation. While the proceeding is not, strictly speaking, an equitable action, yet the relief asked is equitable in its nature. Under such circumstances, it was incumbent upon the thresher company to show its own equities, and that it was in a position to demand such relief. It was not the original creditor of the car company, but the assignee of the original creditors. By that purchase it, of course, succeeded to whatever strictly legal rights its assignors had; but it is not rights of that kind which it is here seeking to enforce. Under such circumstances we think it was incumbent upon it to state what it paid for the claims, or at least to show that it paid a substantial, and not a mere nominal, consideration. The only allegation is that it paid "a valuable consideration." This might have been only one dollar. It appears that it bought the claims after the car company had become insolvent, and its affairs were in the hands of a receiver; also that the indebtedness of that company amounted to about $3,000,000, and that there were not corporate assets enough to pay any considerable part of it. The mere chance of collecting something out of the stockholders does not ordinarily much enhance the selling price of claims against an insolvent corporation. If any person or company had gone to work and bought up for a mere song this large indebtedness of the car company for the purpose of speculating on the lia-

bility of the stockholders, no court would grant them the relief here prayed for. It would say to them, "We will not create and enforce an equity for the benefit of any such speculation." Counsel for respondent suggest that the thresher company is but an organization of the original creditors, who formed it, and pooled their claims, so as to save something out of the wreck of the car company; but nothing of the kind is alleged. On this ground the demurrer should have been sustained.

NOTE. — See, *accord*, *Lea* v. *Iron Belt Co.*, 147 Ala. 421; *State Trust Co.* v. *Turner*, 111 Iowa, 664; *Bank* v. *Northup*, 82 Kan. 638; *Miller* v. *Higgenbotham's Adm'r*, 93 S.W. (Ky.) 655; *Colonial Trust Co.* v. *McMillan*, 188 Mo. 547; *McAllister* v. *American Hospital Ass'n*, 62 Or. 530; *Martin* v. *South Salem Land Co.*, 94 Va. 28; *Adamant Mfg. Co.* v. *Wallace*, 16 Wash. 614, 622; *Gogebic Investment Co.* v. *Iron Chief Mining Co.*, 78 Wis. 427.

EASTON NATIONAL BANK *v.* AMERICAN BRICK CO.

70 N.J. Eq. 732. 1906.

THE question was whether creditors who had extended credit to a corporation knowing that its stock had been issued for overvalued property could require further payments by the stockholders to pay the debts due them. The Court of Errors and Appeals held, by a vote of 11 to 2, that they could.

PITNEY, J. This brings us to a consideration of the grounds upon which the learned vice-chancellor denied the receiver's prayer for relief so far as the Green claims are concerned. There is a line of reported cases holding that stockholders who participate or aid in the issue of paid-up stock upon payment of less than its par value, or who have knowledge of the act and acquiesce therein, cannot afterwards complain of the transaction, either as stockholders or as creditors. Some of these are cited in Cook Stock, § 39, referred to in the opinion of the vice-chancellor. Others will be cited below. So far as we have observed, however, all well-considered decisions that adopt this doctrine are based upon general principles of equity, in the absence of any controlling statute or public policy, resort being had alone to the "trust fund theory" as a basis for the stockholder's liability to creditors. The theory of these cases is that, as between the stockholder and the company, there is no absolute liability to pay for his stock in full, and no legal prohibition standing in the way of an agreement that the stock shall be issued to him for less than full payment. An agreement to this effect is therefore treated as valid between the parties, and subject to avoidance only at the in-

stance of those creditors who have been defrauded by their reliance upon the stock issues as representative of capital actually paid into the company.

The "trust fund theory" has been repeatedly adopted by the courts of this state to the extent that it deals with the capital stock paid in or subscribed for as a fund for the payment of debts of which the directors are trustees, so that they cannot dispose of it to the prejudice of creditors without an equivalent consideration, nor defeat the trust by accepting any simulated payment of a stock subscription, or by any other device short of actual payment in good faith. *National Trust Co.* v. *Miller*, 33 N.J. Eq. (6 Stew.) 155, 163; *Wetherbee* v. *Baker*, 35 N.J. Eq. (8 Stew.) 501, 512; *Bickley* v. *Schlag*, 46 N.J. Eq. (1 Dick.) 533, 537.

But so far as this so-called "trust fund doctrine" excludes any creditors from relief against the stockholders, it does so on the theory that the liability of the latter rests alone upon their having held out the capital of the company to persons extending credit to it as the source from which repayment might be expected. If this be the only foundation of the stockholder's liability, it is perhaps not irrational to debar creditors whose claims accrued prior to the stock issue in question, and subsequent creditors who had notice when they extended credit that the stock issue did not represent in whole or in part what it purported to represent — that is, an equivalent amount in value added to the assets of the company.

But in this state the stockholder's liability to creditors does not depend alone or chiefly upon the theory of "holding out." It depends upon the stockholder's voluntary acceptance, for consideration touching his own interest, of a statutory scheme to which watered stock, under whatever device issued, is absolutely alien, and which requires stock subscriptions to be made good for the benefit of creditors of insolvent companies, without distinction between prior and subsequent creditors, or between creditors who had notice and those who had none. The corporation now under consideration was organized in 1886, under the General Corporation act of New Jersey as it then stood — that is, the act of 1875 and its supplements. Rev. 1877, p. 175; 1 Gen. Stat. p. 907. Section 5 of this act declares that "where the whole capital of a corporation shall not have been paid in, and the capital paid shall be insufficient to satisfy the claims of its creditors, each stockholder shall be bound to pay on each share held by him the sum necessary to complete the amount of such share, as fixed by the charter of the company, or such proportion of that sum as shall be required to satisfy the debts of the company."

Section 54 declares: "that nothing but money shall be considered as payment of any part of the capital stock of any company organized under this act, except as hereinafter provided for the pur-

chase of property, and no loan of money shall be made to a stockholder or officer therein," etc.

Section 55 provides for the issuance of stock for property purchased, to the fair value of such property, but as it has already been determined that this section was not complied with in the present case, it need not be quoted here. Other sections (7, 33, 53, etc.) contain provisions intended to prevent the withdrawal by stockholders, directly or indirectly, of any part of the capital stock to the detriment of creditors.

The express prohibition of § 54 and the whole spirit and policy of the act are so clearly opposed to any arrangement by which corporate stock shall be issued without receipt by the company of an equivalent in value to its par that any agreement to this effect must be deemed void as contrary to the policy of the law. If any doubt has existed upon this question it must be taken as settled by the decision of this court in *Volney* v. *Nixon*, 68 N.J. Eq. 605.

Nor do we deem that the weight of authority in other jurisdictions is to the contrary of this. As already remarked, those cases which are apparently opposed proceed upon a view of the equitable rights of the parties as they exist in the absence of express statutory mandate or prohibition. . . .

In *Hospes* v. *Northwestern Mfg. Co.*, 48 Minn. 174, it was held that if stock is issued by such a corporation upon a contract that it shall not be paid for, its creditors cannot recover payment for such stock on account of the implied promise of the persons receiving it that such payment will be made. Manifestly such a decision could not properly be reached with respect to any corporation organized under the New Jersey law. The opinion contains an interesting criticism of the "trust-fund doctrine," resulting in what seems to be its virtual repudiation. As showing, however, that the doctrine, where recognized, must give place to an express statutory provision, the following excerpt from the opinion is instructive: "In England, since the act of 1867, there is an implied contract created by statute that 'every share in any company shall be deemed and be taken to have been issued and to be held subject to the payment of the whole amount thereof in cash.' This statutory contract makes every contrary contract void. Such a statute would be entirely just to all, for every one would be advised of its provisions and could conduct himself accordingly. And in view of the fact that 'watered' and '*bonus*' stock is one of the greatest abuses connected with the management of modern corporations, such a law might, on grounds of public policy, be very desirable. But this is a matter for the legislature, and not for the courts. We have no such statute."

We do not wish to be understood as assenting to the reasoning of the foregoing cases so far as they debar from recourse to the stockholder's liability those creditors whose claims accrued before the

stock issue in question, and those subsequent creditors who extended credit to the company with knowledge that the stock was issued as full paid when it was not full paid in fact. With respect to prior creditors, the query arises, Why may they not resort to after-acquired property of the company, and as well stock subscriptions as more tangible assets? With respect to subsequent creditors, the query is, Why, if they knew the stock issued as full paid was not full paid in fact, may they not be justified in dealing with the very stockholder's liability thus arising as a part of the assets of the company for the purpose of satisfying creditors' claims? But without spending time in discussion of these questions, we content ourselves with saying that our Corporation act places the stockholder's liability to creditors upon a firmer foundation than the "trust-fund doctrine" as expounded in the above cases, the statute absolutely prohibiting agreements for the issue of stock for a consideration less than its par value, and affording relief to all creditors without distinction.

NOTE. — See, *accord*, *Sprague* v. *National Bank of America*, 172 Ill. 149; *Marion Trust Co.* v. *Bush*, 170 Ind. 686; *Jones* v. *Whitworth*, 94 Tenn. 602.

Cf. Johnson v. *Tennessee Oil Co.*, 74 N.J. Eq. 32.

MEYER *v.* MINING & MILLING CO.

192 Mo. 162. 1905.

MARSHALL, J. . . . The promoters of the scheme secured an option on three mines near Ouray, Colorado, only one of which had been worked, for $125,000, to be paid in installments of $30,000 in 1888, which was paid, $30,000 on the 1st of July, 1889, $30,000 on the 1st of December, 1889, and $35,000 on the 1st of July, 1890. Before the second installment, due July 1, 1889, fell due, the parties became satisfied that the mine was worthless and surrendered their option and ceased business. The original option was taken by Buschman and was afterwards transferred to Chandler, and was turned over by Chandler to the defendant company and constitutes the sole consideration for the 799,840 shares, amounting to $7,998,400, which were issued to Chandler. The only cash that was paid for stock was by the seventeen subscribers, fifteen of whom subscribed for ten shares each and two for five shares each, and those who thus paid cash for stock are not held liable in this case, but their stock has been treated as full-paid. Some of them thereafter acquired portions of the Chandler stock, and those who did so with knowledge of the transaction are the only ones held liable in this case. The company was capitalized for $8,000,000. Thus it appears that with only an

option on an undeveloped, uncertain mine, for which the promoters agreed to pay $125,000, but paid only to $30,000, a company was organized with a capital stock of $8,000,000, and $7,998,400 of stock was attempted to be paid up by the transfer to the company of the option aforesaid.

The mere statement of these facts is a sufficient demonstration of the utter fallacy of the contention. Whatever doubt may have existed, and whatever room for contention there may have been on the subject as to the right of incorporators to turn over property, at a valuation put upon it by them, to the company, in payment of stock issued by the company, prior to the Constitution of 1875, and immediately thereafter, all such questions have been fully and finally set at rest by the clear, exhaustive and unanswerable opinion of BRACE, J., in *Van Cleve* v. *Berkey*, 143 Mo. 109. In that case the decisions in other States were elaborately reviewed, and the decisions of this State, beginning with *Chouteau* v. *Dean*, 7 Mo. App. 210, and running down to *Woolfolk* v. *January*, 131 Mo. 620, were fully set out and considered, and the conclusion drawn as follows: —

"Upon a review of all the cases decided by the appellate courts of this State since the adoption of the Constitution of 1875, the ruling in all of which will be found to be in harmony, it is impossible to escape the conviction that in this State, whatever may be the case in some other States, the American Trust Doctrine, as suggested by Mr. Justice HARLAN, has indeed been 'reinforced' by its Constitution and statutes; and that the proposition that the stock of a corporation must be paid for 'in meal or in malt,' in money or in money's value, is not a mere figure of speech, but has the significance of its terms. It may be paid for in property, but in such case the property must be the fair equivalent in value to the par value of the stock issued therefor; that it is the duty of the stockholders to see that it possesses such value; that when a corporation is sent forth into the commercial world, accredited by them as possessed of a capital in money, or its equivalent in property, equal to the par value of its capital stock, every person dealing with it, unless otherwise advised, has a right to extend credit to it on the faith of the fact that its capital stock has been so paid, and that the money, or its equivalent in property, will be forthcoming to respond to his legitimate demands. In short, that it is the duty of the stockholder, and not of the creditor, to see that it is so paid; hence, the inquiry in a case between the creditor and a stockholder when property has been put in for the capital stock of a corporation, is not whether the stockholder believed, or had reason to believe, that the property was equal in value to the par value of the capital stock, but whether, in point of fact, it was such equivalent."

This case has since been uniformly followed and approved by this court. *Hequembourg* v. *Edwards*, 155 Mo. l.c. 520; *Steam Stone Cutter*

Co. v. *Scott*, 157 Mo. l.c. 525; *Berry* v. *Rood*, 168 Mo. l.c. 330; *Chrisman-Sawyer Co.* v. *Independence Mfg. Co.*, 168 Mo. l.c. 643; *Shields* v. *Hobart*, 172 Mo. l.c. 510; *Rumsey Mfg. Co.* v. *Kaime*, 173 Mo. l.c. 560.

The rule in this State, therefore, is that unpaid subscriptions on capital stock of a corporation, constitute a trust fund for the benefit of creditors, and that whilst incorporators may turn over property instead of cash in payment of stock, that property must be fully equal to the value placed upon it, and its value is determined by the fact and not by the opinions of the persons turning it over, even though they may have honestly believed it to be worth the amount certified; and that all persons who take stock thus paid for with knowledge of the manner in which it was paid, take it subject to the right of a creditor thereof to have the question of whether it has been fully paid or not adjudicated by the court; but that where such stock is acquired by persons who have no knowledge of such facts, but who take it as fully paid and non-assessable stock, they cannot be held liable for any unpaid subscription nor for the difference between the amount they paid for the stock and the par value thereof.

NOTE. — A transferee of stock issued at a discount or for overvalued property, who had notice of the facts at the time of the transfer, is liable to creditors to the same extent that his transferor is liable. See *Allen* v. *Grant*, 122 Ga. 552; *Coleman* v. *Howe*, 154 Ill. 458; *Boulton Carbon Co.* v. *Mills*, 78 Iowa, 460; *Kelly* v. *Clark*, 21 Mont. 291. *Cf. Morgan* v. *Howland*, 89 Me. 484.

But a transferee for value and without notice is not liable. See *Sprague* v. *National Bank of America*, 172 Ill. 149; *Brant* v. *Ehlen*, 59 Md. 1; *Young* v. *Erie Iron Co.*, 65 Mich. 111; *Finletter* v. *Appleton*, 195 Pa. 349; *West Nashville Co.* v. *Nashville Savings Bank*, 86 Tenn. 252; *Davies* v. *Ball*, 64 Wash. 292. *Cf. White, Corbin & Co.* v. *Jones*, 167 N.Y. 158; *Myers* v. *Seeley*, Fed. Cas. 9994.

NOTE.

Constitutional and statutory provisions in the several States, on issues of stock at a discount or for overvalued property, and some of the leading cases, are given below.

Alabama. Section 234 of the Constitution provides that "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void."

Section 3467 of the Code of 1907 provides: "All subscriptions to or for the capital stock of the corporation must be payable in money, but may, except as otherwise provided in this article, be discharged by the rendition of stipulated necessary services or the performance of stipulated necessary labor, or the transfer of property, at the reasonable value thereof, but in such cases the subscription list shall state the names of the subscribers who are privileged to discharge their subscriptions in services or labor or property and the nature and character of the services of [*sic*] labor in which the same are rendered or performed, and the character and a brief description of such property, and when it is to be transferred to the company."

Vaughn v. *Alabama National Bank*, 143 Ala. 572 (1904). If stock is sold by a corporation at a discount, the stockholders may be required to pay the amount remaining unpaid to satisfy creditors.

Elyton Land Co. v. *Birmingham Co.*, 92 Ala. 407 (1890). Extracts from the opinion are set forth, *supra*.

Lea v. *Iron Belt Mfg. Co.*, 147 Ala. 421 (1906). Land costing $100,000 was capitalized at $1,250,000, $250,000 of stock being returned to the treasury of the corporation. This was done during the excitement of a speculative period, when the price of lands was rapidly advancing. The court held (p. 425) that, while there had been no purpose to defraud, nevertheless the land conveyed was not at that time of the money value at which it was estimated, and "the corporators must have known that fact, however much they may have believed it would advance in the future." But subsequent creditors, with knowledge of the facts at the time they became creditors, cannot complain.

Smith v. *Alabama Ass'n*, 123 Ala. 538 (1898). A contract by a corporation to pay a subscriber to its stock, in dividends, an amount equal to the amount the subscriber pays for the stock is unenforcible.

Fitzpatrick v. *Dispatch Publishing Co.*, 83 Ala. 604 (1887). An existing stockholder may restrain an issue of stock not for proper consideration.

Parsons v. *Joseph*, 92 Ala. 403 (1890). If stock has been issued without proper consideration, other stockholders who are injured may have it canceled.

State v. *Webb*, 97 Ala. 111 (1892). Issue of stock without a proper consideration is a cause for the forfeiture of the corporate existence.

Arizona. Section 2102, Civil Code, Revised Statutes of 1913, provides: "All fictitious increase or decrease of stock or indebtedness shall be null and void."

In *Johnson* v. *Tennessee Oil Co.*, 74 N.J. Eq. 32 (1908), a creditor of an Arizona corporation sought to hold the stockholders on the ground that the stock had been issued for overvalued property. The

court said (p. 37): "The capitalization in this case was so grossly excessive as to be fraudulent, and the complainant would be entitled to relief on this ground of fraud but for the fact that he was a subsequent creditor with full notice of the fraudulent overvaluation."

Arkansas. Section 8 of Art. 12 of the Constitution provides: "No private corporation shall issue stocks or bonds, except for money or property actually received or labor done, and all fictitious increase of stock or indebtedness shall be void."

Wait v. *McKee*, 95 Ark. 124 (1910). Directors of an insurance corporation issued its stock as full paid at a 50% discount. Held, that the directors could not be held to have damaged the corporation, until the remedy against the stockholders for the remaining 50% had been proved inadequate. "The stockholders are liable for the full amount of their several stock subscriptions, notwithstanding the wrongful credits on the notes."

Lester v. *Bemis Lumber Co.*, 71 Ark. 379 (1903). The creditor of a Texas corporation was held entitled to collect from stockholders who had received stock for overvalued property. The provision of the Texas Constitution was almost identical with that of the Arkansas Constitution. The stock had been issued for the stock of another corporation, and the court was of opinion (1) that payment of stock in stock of another corporation was invalid: and (2) that, in any event, the stock given in payment was intentionally overvalued to the extent of more than double the actual value. "However honest the intentions of these parties may have been, in law it was a fraud upon the right of the creditors of the corporation, which entitles them to relief."

California. Section 359 of the Civil Code provides: "No corporation shall issue stocks or bonds except for money paid, labor done or property actually received, and all fictitious increase of stock or indebtedness is void."

Vermont Co. v. *Declez Co.*, 135 Cal. 579 (1902). Holders of stock issued at a discount are liable to creditors.

Herron Co. v. *Shaw*, 165 Cal. 668 (1913). Extracts from the opinion in this case are set forth, *supra*.

Colorado. Mills Statutes, 1912, sections 994, 995, and 1008, are as given below. Section 995 is substantially the same as section 9 of Art. xv of the Constitution.

994. The directors or trustees of any corporation may purchase mines, manufactories and other property necessary for their business and issue stock to the amount of the value thereof in payment therefor; and the stock so issued shall be declared and taken to be full-paid stock and not liable to any further calls or assessments, except

as hereinafter provided; neither shall the stockholders thereof be liable to any further payments under the provisions of [§ 1008], but in all statements and reports of the company, this stock shall not be stated or reported as being issued for cash paid into the company, but shall be reported in this respect according to the facts.

995. No corporation shall issue stock or bonds except for labor done, services performed, or money or property actually received, and all fictitious increase of stock or indebtedness shall be void.

1008. Each stockholder shall be liable for the debts of the corporation to the extent of the amount that may be unpaid upon the stock held by him.

There are also provisions relating to mining companies in sections 1109 and 1110.

Felker v. *Sullivan*, 34 Col. 212 (1905). The court leaves open the question whether the trustee in bankruptcy of a corporation may collect from persons to whom stock was issued at a discount.

A. Leschen & Sons Rope Co. v. *Allen*, 187 Fed. 977 (1911). The court construes the Colorado statutes relating to mining companies, and concludes that Colorado differentiates between the incorporation of mining enterprises and general enterprises, and that it permits mining corporations to issue full-paid and non-assessable shares at a price less than par.

In *Buck* v. *Jones*, 18 Col. App. 250 (1903), and *Speer* v. *Bordeleau*, 20 Col. App. 413 (1905), the court did not treat mining corporations as being differentiated from other corporations. In *Buck* v. *Jones* a stockholder of a mining corporation was held liable to creditors. The stock had been issued for the transfer of a location, to which the transferor had not entitled himself, and therefore there was no consideration for the issue. In *Speer* v. *Bordeleau* there was no evidence that the mining property had been received at a fraudulent overvaluation. In *Buck* v. *Jones* there is a dictum that mining stock may be issued for property taken at its "prospective value, that is, value which in the judgment of the parties the property actually has, but which development is necessary to disclose."

Connecticut. Section 12 of chap. 194 of Public Acts of 1903: "If any stock shall be paid for otherwise than in cash, a majority of the directors shall make and sign upon the record book of the corporation a statement showing particularly of what the property received in payment for stock subscriptions consists, and that it has an actual value equal to the amount for which it is so received. The judgment of the directors as to the value of property accepted in payment of stock shall be final; but the directors concurring in the judgment of such value, in case of fraud in the overvaluation of such property, shall be jointly and severally liable to the corporation for the amount of the difference between the actual value of any prop-

erty so accepted in payment at the time of such acceptance, and the amount for which it is received in payment."

New Haven Trust Co. v. *Gaffney*, 73 Conn. 480 (1901). The holder of stock in an insurance corporation issued at a discount is liable to creditors to the extent of the unpaid balance.

Delaware. Section 14 of the General Corporation Law, as amended by chap. 155 of the Laws of 1905, provides: "Subscriptions to, or purchase of, the capital stock of any corporation organized or to be organized under any law of this State may be paid for, wholly or partly, by cash, by labor done, by personal property, or by real property or leases thereof; and the stock so issued shall be declared and taken to be full paid stock and not liable to any further call, nor shall the holder thereof be liable for any further payments under the provisions of this Act. And in the absence of actual fraud in the transaction, the judgment of the Directors, as to the value of such labor, property, real estate or leases, shall be conclusive."

District of Columbia. Section 613 of the Code of Law provides: "No company incorporated under this subchapter shall be authorized to transact any business until ten per centum of the capital stock shall have been actually paid in, either in money or in property at its actual value; and it shall be lawful for the trustees to call in and demand from the stockholders the residue of their subscriptions in money or property at such times and in such installments as the trustees shall deem proper."

Florida. Section 2653 of the Compiled Laws of 1914 provides: "The capital stock of all corporations shall be divided into shares . . . , and all payments of stock and of interest money shall be made in lawful money of the United States unless it be stated in the charter that the capital stock or some therein designated portion of the stock shall be payable in property, labor or services at a just valuation to be fixed by the incorporators, or by the directors at a meeting called for such purpose. Property, labor or services may also be purchased or paid for with capital stock at a just valuation of such property, labor or services, to be fixed by the directors of the company at a meeting called for such purpose."

Knight & Wall Co. v. *Tampa Brick Co.*, 55 Fla. 728 (1908). Holders of stock issued as a bonus upon the purchase of bonds are liable to creditors.

Georgia. Allen v. *Grant*, 122 Ga. 552 (1905). If stock is issued for property known to be worth not more than 10 per cent of the par value of the stock, the holders are liable to creditors. "If the contract to receive less in money than the face of the stock will not defeat

his right to recover, neither should it be defeated by a fraudulent agreement to receive less in property. . . . Neither the corporation nor the subscriber, nor the two together, can defeat the creditor's rights. They can not do so by an express contract to issue non-assessable fully paid-up stock for any number of dollars less than the amount of the subscription. Neither can they bring about such a result by agreeing to receive property whose value is less than the amount of the subscription."

Idaho. Section 9 of Art. 11 of the Constitution provides: "No corporation shall issue stocks or bonds, except for labor done, services performed, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void."

Section 2769 of the Revised Codes, as amended by the Laws of 1909, p. 164, provides: "When any corporation shall issue stock or bonds for labor done, services performed or property actually received, the judgment of the directors of such corporation as to the value of such labor, services, or property shall, in the absence of fraud in the transaction, be conclusive."

See *Wall* v. *Basin Mining Co., Ltd.*, 16 Idaho, 313.

Illinois. *Bates* v. *Great Western Tel. Co*, 134 Ill. 536 (1890). Holders of stock issued as fully paid at a discount are liable to creditors.

Coleman v. *Howe*, 154 Ill. 458 (1895). Holders of stock issued as fully paid for overvalued property are liable to creditors. Here property worth $75,000 was capitalized at $300,000, and the parties knew that the property was being overvalued. An extract from the opinion is set forth, *supra*, in the note to *Douglass* v. *Ireland*.

Gillett v. *Chicago Title & Trust Co.*, 230 Ill. 373 (1907). Extracts from the opinion are set forth, *supra*.

Section 25 of chap. 32 of the Revised Statutes of 1913 (HURD) provides: "If any corporation . . . shall allow any execution or decree of any court of record, for a payment of money, after demand made by the officer, to be returned 'No property found' . . . suits in equity may be brought against all persons who were stockholders at the time, or liable in any way, for the debts of the corporation, by joining the corporation in such suit; and each stockholder may be required to pay his pro rata share of such debts or liabilities to the extent of the unpaid portion of his stock, after exhausting the assets of such corporation."

Sprague v. *National Bank of America*, 172 Ill. 149 (1898). The rights of creditors are not dependent, in any degree, upon their knowledge, at the time of extending credit, that subscriptions to stock were not paid in full. The statute [the provisions, now section 25 of chap. 32 of Revised Statutes of 1913, given above, were

then in force] expressly declares that the creditor shall be invested with a right to recover if the stock has not been fully paid. "The legislative intent was, that any amount unpaid upon subscription to the capital stock of a corporation should constitute a fund, to which a creditor of the corporation might resort to obtain satisfaction of his demand against the corporation" (p. 169).

Parmalee v. *Price*, 208 Ill. 544 (1904). "The stock of appellees was paid for partly in cash and partly in property, and this property was fraudulently overvalued to such an extent that in fact only forty per cent of the subscription was paid. While this transaction was voidable as to creditors or other stockholders prejudiced thereby, it was binding upon the corporation."

People v. *Sterling Mfg. Co.*, 82 Ill. 457 (1876). Stock was issued as full paid, upon the receipt of a fraction of the par value. Later the corporation resolved that all the fictitious stock should be canceled. One stockholder refused to comply with the resolution, and it was held that he could not compel the corporation to transfer his stock to his assignee.

Indiana. Bent v. *Underdown*, 156 Ind. 516 (1900). Where it was provided in the articles of association of a corporation that only 15 per cent of the par value of each share of stock should be paid, this was held binding on creditors on the ground that they were affected with notice of the contents of the articles.

Coffin v. *Ransdell*, 110 Ind. 417 (1886). The opinion in this case is set forth, *supra*.

Brown v. *Clow*, 158 Ind. 403 (1901). Where mortgage bonds of the corporation and substantially all its capital stock are issued for property which is worth less than the amount of the mortgage bonds, this is an improper issue of stock, and the directors are responsible for the consequences.

It would seem to follow from *Marion Trust Co.* v. *Blish*, 170 Ind. 686 (1908), that, if a receiver should be permitted to recover from stockholders for unpaid subscriptions, all the creditors would share in the amounts recovered.

Iowa. Sections 1641b of the Code Supplement, 1907, provides that no stock shall be issued "until the corporation has received the par value thereof. If it is proposed to pay for said capital stock in property or in any other thing than money, the corporation proposing the same must, before issuing capital stock in any form, apply to the executive council of the state of Iowa for leave so to do. Such application shall state the amount of capital stock proposed to be issued for a consideration other than money, and set forth specifically the property or other thing to be received in payment for such stock. Thereupon, it shall be the duty of the executive council to make

investigation, under such rules as it may prescribe, and to ascertain the real value of the property or other thing which the corporation is to receive for the stock; and shall enter its finding, fixing the value at which the corporation may receive the same in payment for capital stock; and no corporation shall issue capital stock for the said property or thing in a greater amount than the value so fixed and determined by the executive council." This provision was enacted in 1907. See chap. 71, Acts 32 G.A.

Boulton Carbon Co. v. *Mills*, 78 Iowa, 460 (1889). Holder of stock issued as a bonus was held liable to creditors.

State Trust Co. v. *Turner*, 111 Iowa, 664 (1900). Stock had been issued as full paid in payment of a patent. The court reviewed the authorities and said that holders of stock issued for overvalued property were liable to creditors to the extent of the overvaluation. "The parties have the right in good faith to agree on the value of the property taken, but this should not be a speculative or fictitious one. An honest mistake in judgment will not necessarily destroy the value agreed upon, but it must be such a valuation as prudent and sensible business men would approve" (p. 671).

But the holders are not liable to creditors who extended credit to the corporation with knowledge of the facts.

Sykes v. *Pure Food Cider Co.*, 157 Iowa, 601 (1912). Stock was issued for property in 1909, without leave from the Executive Council. The parties seem to have gone through the form of paying in money to the corporation and paying it out again for the property. The certificates of stock recited that they had been paid in cash. The corporation became insolvent. A purchaser of some of the stock so issued was allowed to recover the amount paid for his stock from an officer of the corporation who had taken part in authenticating and issuing the certificates.

Kansas. Bank v. *Northup*, 82 Kan. 638 (1910). Stockholders in a corporation decided that certain property could be handled to better advantage by a separate corporation. They agreed among themselves that the property was worth $25,000 and that any stockholder not desiring to take his share of the stock of the new company should be entitled to his share of $25,000. The property was capitalized at $1,000,000, and the stockholders were held liable to creditors. The court treated the case as substantially the same as a case of issue of stock at a discount.

It cited with approval the decisions that creditors cannot complain who extend credit with a knowledge of the facts, but held that the creditor in question had no knowledge of the facts. And see *Walburn* v. *Chenault*, 43 Kan. 352 (1890).

Kentucky. Section 193 of the Constitution provides: "No corporation shall issue stocks or bonds except for an equivalent in

money paid or labor done, or property actually received and applied to the purposes for which such corporation was created, and neither labor nor property shall be received in payment of stock or bonds at a greater value than the market price at the time such labor was done or property delivered, and all fictitious increase of stock or indebtedness shall be void." And see Ky. Stat., section 568.

Haldeman v. *Ainslie*, 82 Ky. 395 (1884). The court said that if stock is issued at a discount the holders are liable to creditors. But a creditor cannot complain who extended credit with knowledge of the facts. *Miller* v. *Higgenbotham's Adm'r*, 93 S.W. 655.

Kentucky Mutual Co. v. *Schaefer*, 120 Ky. 227 (1905). The court said (p. 229) that stockholders "must be held liable [to creditors] for the difference between the amount they actually paid and the amount of stock they received, at par value. The fact that they did not pay any money, but paid in something else, is immaterial."

Horton v. *Sherrill-Russell Lumber Co.*, 147 Ky. 226 (1912). The question considered by the court was whether the stockholders of a foreign corporation to whom stock had been issued as full-paid for overvalued property were liable to creditors "at common law." The court, relying on Cook on Corporations, held that they were not. But the question remains whether the statement in Cook is justified by the authorities; in the opinion of the editor it is not.

Louisiana. Section 3 of Act 267, 1914, provides: "Where subscriptions to the capital stock of a corporation organized under this act consist, in whole or in part, of property or good will, there must appear in, or be annexed to, the articles of incorporation and be read in connection therewith, an accurate detailed and itemized description of such property, as to amount, location, extent, character and state of improvement, together with a statement of its value as appraised by the directors, and a statement of the value placed upon any good will included in the capital stock. . . . Stock so issued shall, in the absence of fraud, be full-paid stock." And see Art. 266 of the Constitution.

Belknap v. *Adams*, 49 La. Ann. 1350 (1897). Holders of stock issued without consideration are liable to creditors, even if the stock had been purchased by the corporation and reissued.

Dilzell Engineering Co. v. *Lehmann*, 120 La. 273 (1907). The value of the labor or property received in payment of the stock must be equal to the face value of the stock. "To the extent, therefore, of the difference between the value of the lease and charred ruins given for the stock and the face value of the 602 shares of stock, defendants are liable to the creditors of the corporation." And see *Webre* v. *Christ*, 130 La. 450 (1912).

Maine. Section 50 of chap. 47 of the Revised Statutes (1904) provides: "Any corporation may purchase mines, manufactories

and other property necessary for its business, and the stock of any company or companies owning, mining, manufacturing or producing materials or other property necessary for its business, and issue stock to the amount of the value thereof in payment therefor, and may likewise issue stock for services rendered to such corporation and the stock so issued shall be full-paid stock and not liable to any further call or payment thereon; and in the absence of actual fraud in the transaction, the judgment of the directors as to the value of the property purchased, or services rendered, shall be conclusive." This provision was enacted in 1901. In the report of the Commissioner on the Revision of the Public Laws, dated December 15, 1914, this provision is drafted as section 54 of chap. 49.

Barron v. *Burrill*, 86 Me. 66 (1893). Persons to whom stock is issued at a discount are liable to creditors.

Gillin v. *Sawyer*, 93 Me. 151 (1899). The court was construing an earlier statute, and held that the creditors might "go behind even the honest opinion of the directors of the corporation and question the actual sufficiency of the consideration paid for the shares."

Maryland. Sections 35 and 36 of chap. 240 of Acts of 1908 (sections 35 and 36 of Art. 23 of Bagby's Annotated Code) provide that stock may be issued for services or for property; "that the value of such services and property, and the propriety of issuing stock therefor, shall be agreed upon and the issue authorized by the affirmative vote of a majority of all the stock"; that a certificate particularly specifying the nature and character of such property or services shall be filed in a designated public office; and "that the valuation placed by the stockholders upon such services or property . . . shall in the absence of actual fraud be conclusive against and binding upon any and all creditors of the corporation."

Hooper v. *Central Trust Co.*, 81 Md. 559, 580 (1895). Persons to whom stock was issued without consideration are liable to creditors. And see *Hughes* v. *Hall*, 117 Md. 547 (1912).

Brant v. *Ehlen*, 59 Md. 1 (1882). Creditors were pursuing the stockholders of a West Virginia corporation, most of the stock of which had been issued for property. The court said (p. 29) that "so long as the transaction stands unimpeached for fraud, courts will treat as a payment that which the parties themselves have agreed shall be a payment, and this too in cases where the rights of creditors are involved."

Crawford v. *Rohrer*, 59 Md. 599 (1882). The court said (p. 604): "Any arrangement, therefore, among the stockholders, or those in charge of the affairs of the corporation, by which the stock is but nominally paid for, whether in money or property, the corporation not in fact getting the benefit of the price in good faith, will be regarded as a sham, and not as a valid payment, as against the cred-

itors of the corporation, however it may be regarded as between the corporation and the subscriber."

Massachusetts. Section 14 of chap. 437 of the Acts of 1903 provides that stock "may be issued for cash, property, tangible or intangible, services or expenses." Sections 11 and 14 provide, in case stock is issued for property or services that a statement of the description of the property shall be prepared and filed in a designated public office. "If such property consists in any part of real estate, its location, area and the amount of stock to be issued therefor shall be stated; if any part of such property is personal, it shall be described in such detail as the commissioner of corporations may require, and the amount of stock to be issued therefor stated. If any part of the capital stock is issued for services or expenses, the nature of such services or expenses and the amount of stock which is issued therefor shall be clearly stated."

Under the statute in force prior to the adoption of chap. 437 of the Acts of 1903, if stock were paid in property, the commissioner of corporations was required to certify that he was satisfied that the valuation put upon the property was a fair and reasonable one. (Section 23 of chap. 109 of R.L.)

Cabot Bridge v. *Chapin*, 6 Cush. 50 (1850). Where the defendant subscribed to stock on the condition that a total of 400 shares should be subscribed for, he cannot be held on his subscription where some of the other subscriptions were payable in property worth less than the par of the shares.

New Haven Horse Nail Co. v. *Linden Spring Co.*, 142 Mass. 349 (1886). The court declined to determine the liability to creditors of stockholders of a Connecticut corporation by reason of receiving stock issued in payment of overvalued property. There is a *dictum* by DEVENS, J., as follows: "That, in the absence of fraud, an agreement may ordinarily be made by which stockholders can be allowed to pay for their shares in patents, mines, or other property, to which it is not easy to assign a determinate value, appears to be well settled. The bill does not aver any fraud actually committed, or intended to be committed, upon the public or the plaintiff, by these defendants, by obtaining from those with whom the corporation dealt a false credit."

Anthony Co. v. *Metropolitan Art Co.*, 190 Mass. 35 (1906). The court was considering the liability of the officers and stockholders of a foreign corporation, doing business in Massachusetts, under a statute which imposed liability to creditors if the capital stock of the corporation had been paid by a conveyance to the corporation of property at an unfair valuation. The court held that the liability was incurred. The defendants did not have any fraudulent intent, or actual knowledge that the values were false, or wilful intent to

make a false statement, but did have reasonable cause to know, and they ought to have known, that the valuation was an unfair one.

Harvey-Watts Co. v. *Worcester Umbrella Co.*, 193 Mass. 138 (1906). The court was considering the liability of officers of a corporation formed while R.L. chaps. 109 and 110 were in force. It held that, if a stockholder gave to the corporation a check in payment of his subscription, and the corporation then gave the stockholder a check of a like amount for an assignment of property, the stock was not paid in cash within the meaning of the statute.

On the propriety of ever speaking of a stockholder's liability to creditors as "a common-law obligation," see *New Haven Horse Nail Co.* v. *Linden Spring Co.*, 142 Mass. 349, 353.

Michigan. Section 2 of Act 146 of the Laws of 1907 (section 9533 of Howell's Annotated Statutes, 1913) provides: "Such capital stock may be paid in, either in cash or in other property, real or personal; but where payment is made otherwise than in cash there shall be included in the articles an itemized description of the property in which such payment is made, with the valuation at which each item is taken, which valuation shall be conclusive in absence of actual fraud: *Provided*, That only such property shall be so taken in payment for capital stock as the purposes of the corporation shall require, and only such property as can be sold and transferred by the corporation, and as shall be subject to levy and sale on execution, or other process issued out of any court having competent jurisdiction, for the satisfaction of any judgment or decree against such corporation: And *Provided further*, That there shall be made and attached to any such articles of association an affidavit by at least three of the organizers of such corporation, that they know the property described in such articles of association and that the same has been actually transferred to such corporation, and that such property is of the actual value therein stated."

Utica Fire Alarm Co. v. *Waggoner Clock Co.*, 166 Mich. 618 (1911). Persons to whom stock is issued at a discount are liable to creditors.

Graves v. *Brooks*, 117 Mich. 424 (1898). Patents worth $20,000 were capitalized at $100,000. The court held that the stockholders were not liable to creditors; that it was not enough to show that the property was overvalued, but that it was necessary to establish "either an intentional fraud in fact, or such reckless conduct in fixing the value of the property conveyed, without regard to its actual value, that an intent to defraud may be inferred."

Dieterle v. *Paint & Enamel Co.*, 143 Mich. 416 (1906). Stock was paid for in the stock of another corporation which was in fact insolvent, and in a secret formula. Stockholders were held liable to creditors. "However much the original shareholders may have

acted in good faith as to the creditors, what was done was as to them a fraud" (p. 422). And see *Wood* v. *Sloman*, 150 Mich. 177 (1907).

Minnesota. See section 6193 of General Statutes, 1913.

McConey v. *Belton Oil Co.*, 97 Minn. 190 (1906). The corporation in question was an Arizona corporation. A person to whom stock was issued at a discount was held liable to creditors. Otherwise, as to mining companies, owing to provisions in the General Statutes of 1878, peculiar to mining corporations: *Ross* v. *Kelly*, 36 Minn. 38 (1887).

Hastings Malting Co. v. *Iron Range Co.*, 65 Minn. 28 (1896). Persons to whom stock was issued for overvalued property were held liable to creditors.

Hospes v. *Northwestern Car Co.*, 48 Minn. 174 (1892). Extracts from the opinion in this case are set forth, *supra*.

State v. *Minnesota Thresher Mfg. Co.*, 40 Minn. 213, 226 (1889). The court refused to declare the franchise of a corporation forfeited because it had issued stock for overvalued property.

Mississippi. Section 921 of Code of 1906 provides: "A note, obligation, or security of any kind given or transferred by any subscriber for stock in any corporation shall not be considered, taken, or held as payment of any part of the capital stock of the company."

Alford v. *Improvement Co.*, 86 Miss. 375 (1905). The court, commenting on the statutory provision which is now section 921 of the Code of 1906, said: "The plain intendment of the law being that all stock must be fully and actually paid for."

Lee v. *Cutrer*, 96 Miss. 355 (1909). The majority of the court construed a statute requiring the payment of the capital stock in cash as permitting it to be paid in property or services. There seems to have been no question but that the property and services were taken at a fair valuation.

Missouri. Section 8 of Art. XII of the Constitution provides: "No corporation shall issue stock or bonds, except for money paid, labor done or property actually received, and all fictitious increase of stock or indebtedness shall be void." Same, Revised Statutes, 1909, section 2981.

Skrainka v. *Allen*, 76 Mo. 384 (1882). A person to whom stock is issued at a discount is liable to creditors.

Van Cleve v. *Berkey*, 143 Mo. 109 (1897). See extract from the opinion in this case cited in *Meyer* v. *Mining Co.*, *supra*.

Berry v. *Rood*, 168 Mo. 316 (1901). Lands in which were certain onyx deposits were capitalized (with other property) at a figure largely in excess of their value. But the trier of the facts found that the incorporators acted without any intent to defraud; that they

valued the properties as a whole believing that the corporation could earn a dividend of at least six per cent on the valuation; and that if the lands "had been really lands having large deposits of onyx of good quality, they might well have been thought worth the par value of the stock issued for them." The court held that the stockholders were liable to creditors for the difference between the par value of their stock and the actual value of the property transferred. Property could not be capitalized at its imagined future worth. The inquiry "is not whether the stockholder believed or had reason to believe that the property was equal in value to the par value of the capital stock; but whether, in point of fact, it was such equivalent."

Colonial Trust Co. v. *McMillan*, 188 Mo. 547 (1905). A creditor who knew the facts when he extended credit is not entitled to complain.

Montana. Section 10 of Art. xv of the Constitution provides: "No corporation shall issue stocks or bonds, except for labor done, services performed, or money and property actually received; and all fictitious increase of stock or indebtedness shall be void."

Section 3824 of the Revised Codes, 1907, provides: "The directors of any corporation may purchase mines, manufactories and other property necessary for its business and issue stock to the amount of the value thereof in payment therefor, and the stock so issued shall be declared and taken to be full-paid stock and not liable to any further call, neither shall the holders thereof be liable for any further payments under the provisions of § 3853 this Code; *Provided*, That on mines any arbitrary value may be fixed and such value shall, regardless of the actual value, be deemed the value thereof, so as to make the stock issued in payment therefor at such arbitrary value, full-paid stock as above defined."

See *Kelly* v. *Clark*, 21 Mont. 291 (1898).

Nebraska. See *Gilkie Co.* v. *Dawson Gas Co.*, 46 Neb. 333 (1895), and *Penfield* v. *Dawson Gas Co.*, 57 Neb. 231 (1898). The opinion in the latter case is set forth, *supra.*

York Park Bld'g Ass'n v. *Barnes*, 39 Neb. 834 (1894). If stock is issued without consideration, the corporation may compel the holder to pay therefor.

State v. *Atchison R.R. Co.*, 24 Neb. 143 (1888). The improper issue of stock is a cause for the forfeiture of the corporate franchise.

Nevada. Sections 1155 and 1156 of the Revised Laws, 1912, provide: "Any corporation existing under any law of this state may issue stock for labor done or personal property or real estate or leases thereof; in the absence of fraud in the transaction, the judgment of the directors as to the value of such labor, property, real

estate or leases shall be conclusive. All [such] stock . . . shall be fully paid and not liable to any further call or assessment (and this shall be so stated on the face of the certificate). But it shall be the duty of the corporation to have its minutes or other permanent records to show, with reasonable detail, the items and character of property (and of the labor or services) for which any stock or bonds were so issued."

As to mining corporations, see sections 1200, and 1332 to 1335, and *State* v. *Manhattan Verde Co.*, 32 Nev. 474.

New Hampshire. Sections 9 and 10 of chap. 149 of the Public Statutes (1901) provides: "No corporation shall sell or dispose of any of the shares of its capital stock at a price less than the par value thereof, except in sales of shares at auction for nonpayment of assessments. . . . No certificate shall be issued until the par value of the shares mentioned in it has been fully paid to the corporation."

Section 9 of chap. 150 provides: "No note or obligation given by a stockholder, whether secured by pledge or otherwise, shall be considered as payment of any part of the capital stock."

Libby v. *Mt. Monadnock Co.*, 67 N.H. 587 (1893). Stockholders are liable to pay for their stock in full, although there was an oral agreement with the promoters that they were to pay only a fraction of the par value.

Peterborough R.R. Co. v. *Nashua R.R. Co.*, 59 N.H. 385 (1879). A corporation may borrow money and pledge an amount of its stock as collateral equal to the amount borrowed, and if on default the pledgee sells, the corporation is liable for the deficiency.

Kimball v. *Grate Co.*, 69 N.H. 485 (1898). 2997 shares of stock were issued in payment of a patent. On the same day 1497 of these shares were transferred to a trustee for the benefit of the corporation. The referee found that the pretended issue of the 1497 shares was without consideration, and the court said that no part of such shares could be reissued, even to *bona fide* purchasers, except upon payment of the par value. The bill was by stockholders in the corporation, who prayed that a part of these 1497 shares should be canceled. This relief was granted. The court said that the validity of this issue was open to several objections, of which the objection noted above was one.

New Jersey. Sections 48 and 49 of an act concerning corporations (Revision of 1896) provided: "Nothing but money shall be considered as payment of any part of the capital stock of any corporation organized under this act, except as hereinafter provided in case of the purchase of property. . . ."

Section 49: "Any corporation formed under this act may purchase mines, manufactories or other property necessary for its busi-

ness, or the stock of any company or companies owning, mining, manufacturing or producing materials, or other property necessary for its business, and issue stock to the amount of the value thereof in payment therefor, and the stock so issued shall be full-paid stock and not liable to any further call, neither shall the holder thereof be liable for any further payment under any of the provisions of this act; and in the absence of actual fraud in the transaction, the judgment of the directors as to the value of the property purchased shall be conclusive; and in all statements and reports of the corporation to be published or filed this stock shall not be stated or reported as being issued for cash paid to the corporation, but shall be reported in this respect according to the fact."

Section 49 was amended by chap. 15 of the Acts of 1913 so as to read as follows: "Any corporation formed under this act may purchase property, real and personal, and the stock of any corporation, necessary for its business, and issue stock to the amount of the value thereof in payment therefor, subject to the provisions hereinafter set forth, and the stock so issued shall be full-paid stock, and not liable to any further call; and said corporation may also issue stock for the amount it actually pays for labor performed.

"*Provided*, that when property is purchased the purchasing corporation must receive in property or stock what the same is reasonably worth in money at a fair, bona fide valuation; *and provided further*, that no fictitious stock shall be issued; that no stock shall be issued for profits not yet earned, but only anticipated; *and provided further*, that when stock is issued on the basis of the stock of any other corporation it may purchase, no stock shall be issued thereon for an amount greater than the sum it actually pays for such stock in cash or its equivalent; *and provided further*, that the property purchased or the property owned by the corporation whose stock is purchased shall be cognate in character and use to the property used or contemplated to be used by the purchasing corporation in the direct conduct of its own proper business; and in all cases when stock is to be issued for property purchased, or for the stock of other corporations purchased, a statement in writing, signed by the directors of the purchasing company or by a majority of them, shall be filed in the office of the Secretary of State, showing what property has been purchased, and what stock of any other corporation has been purchased, and the amount actually paid therefor." [Signing a false statement is made a misdemeanor.]

Hebberd v. *Southwestern Land & Cattle Co.*, 55 N.J. Eq. 18, 31 (1896). Persons to whom stock is issued as a bonus are liable to creditors.

See v. *Heppenheimer*, 69 N.J. Eq. 36 (1905). Extracts from the opinion in this case are set forth, *supra.*

Holcombe v. *Trenton White City Co.*, 80 N.J. Eq. 122 (1912). The

court held that the provision of section 49 of the Act of 1896, that "in the absence of actual fraud in the transaction, the judgment of the directors as to the value of the property purchased shall be conclusive," was merely declaratory, and that the standards fixed by *See* v. *Heppenheimer* applied where the stock was issued after the enactment of such provision.

Easton National Bank v. *American Brick Co.*, 70 N.J. Eq. 732 (1906). Extracts from the opinion in this case are set forth, *supra.*

Arnold v. *Searing*, 73 N.J. Eq. 262 (1907). Holder of stock issued as a bonus has a standing to bring a suit as a stockholder.

New Mexico. Sections 56 and 57 of chap. XXIII of the Statutes (1915) contain, in substance, the same provisions as sections 48 and 49 of the Corporation Act of New Jersey, set forth above, *prior* to the amendments made in 1913.

Medler v. *Hotel Co.*, 6 N.M. 331, 344 (1892). It was held that the facts did not show either an intentional overvaluation of the property taken in payment of stock, or such a great discrepancy between the actual value of the property and the amount of the stock as to raise a presumption of fraud in law.

New York. Section 55 of the Stock Corporation Law (Consolidated Laws of 1909) provides: "No corporation shall issue either stock or bonds except for money, labor done or property actually received for the use and lawful purposes of such corporation. Any corporation may purchase any property authorized by its certificate of incorporation, or necessary for the use and lawful purposes of such corporation, and may issue stock to the amount of the value thereof in payment therefor, and the stock so issued shall be full-paid stock and not liable to any further call, neither shall the holder thereof be liable for any further payment under any of the provisions of this chapter; and in the absence of fraud in the transaction the judgment of the directors as to the value of the property purchased shall be conclusive; and in all statements and reports of the corporation, by law required to be published or filed, this stock shall not be stated or reported as being issued for cash paid to the corporation, but shall be reported as issued for property purchased."

Section 42 of chap. 564 of the Laws of 1890 provided: "No corporation shall issue either stock or bonds except for money, labor done, or property actually received for the use and lawful purposes of such corporation, at its fair value, and all stock issued in violation of the provisions of this section shall be void." This was amended in 1892 so as to read: "No corporation shall issue either stock or bonds except for money, labor done or property actually received for the use and lawful purposes of such corporation. No such stock shall be issued for less than its par value. No such bonds shall be

issued for less than the fair market value thereof." Section 42 of chap. 688 of the Law of 1892. This was amended in 1901 into a provision substantially the same as the existing provision. Chap. 354 of the Laws of 1901.

The substance of the provisions of chap. 40 of the Laws of 1848, and chap. 333 of the Laws of 1853 appears from the opinions in *Douglass* v. *Ireland*, 73 N.Y. 100, and *Lake Superior Iron Co.* v. *Drexel*, 90 N.Y. 87, extracts from which are set forth, *supra*.

Chap. 351 of the Laws of 1912 makes it legal to form some corporations having stock without a par value.

Section 10 of the Stock Corporation Law contains special provisions relating to the issue of securities by a corporation formed to take over the properties of a corporation bought at foreclosure sale.

Southworth v. *Morgan*, 205 N.Y. 293 (1912). Extracts from the opinion in this case are set forth, *supra*.

Douglass v. *Ireland*, 73 N.Y. 100 (1878). Extracts from the opinion in this case are set forth, *supra*.

Lake Superior Iron Co. v. *Drexel*, 90 N.Y. 87 (1882). Extracts from the opinion in this case are set forth, *supra*.

Flour City National Bank v. *Shire*, 88 N.Y. App. Div. 401, aff'd 179 N.Y. 587 (1904). The corporation in question was formed, and the stock issued, in 1899. HISCOCK, J., said (p. 407): "In our judgment the evidence fully justified the referee in finding such a disparity between the actual value of the property thus transferred and the amount of capital stock issued therefor, as to take the transaction outside of the rule making allowance for discretion and even honest error in the judgment of directors executing such a transaction, and to take it within the rule which governs where such directors have been guilty of willful and intentional overvaluation and resultant fraud."

As to the persons entitled to require the stockholders to make further payments, where stock has been issued for overvalued property, see *Bostwick* v. *Young*, 118 N.Y. App. Div. 490, aff'd 194 N.Y. 516 (1909), and *In re Jassoy Co.*, 178 Fed. 515 (1910).

As to issues of stock made after the amendment in 1901 see *People* v. *Public Service Commission*, 158 N.Y. App. Div. 251 (1913), and *Archer* v. *Hesse*, 164 N.Y. App. Div. 493 (1914). In the latter case MCLAUGHLIN, J., said (p. 496): "It could issue the same provided full value were received for services rendered, property purchased, or money paid."

As to section 10 of the Stock Corporation Law see *People* v. *Public Service Commission*, 203 N.Y. 299 (1911).

North Carolina. Sections 1159 and 1160 of the Statutes (Pell's Revisal, 1908) provide: "When any corporation shall issue stock for labor done or personal property or real estate, or leases thereof,

which stock may be so issued by any corporation, in the absence of fraud in the transaction, the judgment of the directors as to the value of such labor, property, real estate or leases shall be conclusive.

"Nothing but money shall be considered as payment of any part of the capital stock of any corporation organized under this chapter, except as herein provided in case of the purchase of property or labor performed."

Bernard v. *Carr*, 167 N.C. 481 (1914). A person to whom stock is issued as a bonus is liable to creditors.

Hobgood v. *Ehlen*, 141 N.C. 344 (1906). The stock was issued by a Delaware corporation, the Delaware statute making the judgment of the directors conclusive, in the absence of actual fraud. The stockholder was held liable to creditors. The court said (p. 354): "The property must be taken at its reasonable monetary value. Although a margin may be allowed for an honest difference of opinion as to value, a valuation grossly excessive, knowingly made, while its acceptance may bind the corporation, is a fraud on creditors and they may proceed against the stockholder individually, who sells the property, as for an unpaid subscription." See *Whitlock* v. *Alexander*, 160 N.C. 465 (1912).

North Dakota. Sections 4527 and 4528 of the Civil Code (Compiled Laws, 1913) provide: "No corporation shall issue any certificates of stock under an agreement or with the understanding that the full par value shall not be paid. Any officer of a corporation who issues certificates of stock in violation of the provisions of this chapter, or who has knowledge thereof, and does not at the time dissent therefrom in writing shall be liable to the creditors of the corporation and to purchasers in good faith of such stock for all damages they may sustain thereby.

"No corporation shall issue stock or bonds except for money, labor done or property, estimated at its true money value, actually received by it, and all the officials of a corporation who consent to the issuance of stock or bonds for labor or property in excess of its actual cash value, or who have knowledge thereof and do not at the time dissent therefrom in writing shall be jointly and severally liable to the creditors of such corporation for the difference between the actual cash value of such labor or property at the time such stock or bonds were issued and the par value of the stock or bonds issued therefor."

Ohio. Gates v. *The Tippecanoe Stone Co.*, 57 Ohio St. 60 (1897). Property was capitalized at twice its value. The trier of the facts found that the parties acted in good faith, and without an intent to defraud the creditors of the corporation or any one else. A stock-

holder was held liable to creditors. "Notwithstanding the frequency with which corporations are created with fictitious capital, persons who have occasion to deal with those organized under the laws of this state and doing business within its borders, are not bound to anticipate this condition of its affairs, but may assume that it is what it purports to be."

Oklahoma. Section 39 of Art. IX of the Constitution provides: "No corporation shall issue stock except for money, labor done, or property actually received to the amount of the par value thereof, and all fictitious increase of stock or indebtedness shall be void, and the Legislature shall prescribe the necessary regulations to prevent the issue of fictitious stock or indebtedness."

See *Webster* v. *Webster Refining Co.*, 36 Okl. 168 (1912).

Oregon. See section 3 of Art. XI of the Constitution and section 5833 of Lord's Oregon Laws (1910).

McAllister v. *American Hospital Ass'n*, 62 Or. 530 (1912). Holders of stock issued as a bonus or at a discount are liable to creditors. *Dictum*, that no creditors may complain except those who have relied upon the representation that the capital stock was paid in full.

Macbeth v. *Banfield*, 45 Or. 553 (1904). The owners of a business associated with themselves other persons who put $5000 cash into the business. Those who advanced the cash were to have a one-half interest in the business. Then forthwith the assets of the business (other than the $5000 cash) were capitalized at $16,000. The court found that there was conscious overvaluation, and that the stockholders were liable to creditors.

Pennsylvania. Section 7 of Art. XVI of the Constitution provides: "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void."

Section 17 of Act of April 29, 1874, P.L. 73 (Purden's Digest, vol. I, p. 803), provides: "Every corporation created under the provisions of this act, or accepting its provisions, may take such real and personal estate, mineral rights, patent rights, and other property, as is necessary for the purposes of its organization and business, and issue stock to the amount of the value thereof, in payment thereof, and the stock so issued shall be declared and taken to be full-paid stock, and not liable to any further calls or assessments; and in the charter and the certificates and statements to be made by the subscribers and officers of the corporation, such stock shall not be stated or certified as having been issued for cash paid into the company, but shall be stated or certified in this respect according to the fact.

No such corporation shall issue either bonds or stock except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness in any form shall be void." [This section was amended in 1876, but not so as to alter the provisions set forth above.]

By the same law it is also provided: "No note or obligation given by a stockholder, whether secured by pledge or otherwise, shall be considered as a payment of any part of the capital stock."

Guarantee Trust Co. v. *Dilworth Coal Co.*, 235 Pa. 594 (1912). The opinion in this case is set forth, *supra*.

It is apparently the law of Pennsylvania that property may be capitalized at any value which the incorporators believe it will develop, rather than the present cash value. See *Carr* v. *Le Fevre*, 27 Pa. 413, 417 (1856); *Commonwealth* v. *Central Passenger Ry.*, 52 Pa. 506, 515 (1866); *American Tube Co.* v. *Baden Gas Co.*, 165 Pa. 489 (1895); and *Finletter* v. *Acetylene Light Co.*, 215 Pa. 86 (1906).

Rhode Island. The editor has found nothing coming within the scope of this note.

South Carolina. Section 2836 of the Civil Code, 1912, provides: "All subscriptions to the capital stock of any corporation organized under this Article shall be payable in money, or in labor or in property at its money value, and shall be listed, the labor or the property and the value thereof to be specified in the list of subscriptions; but no subscription in labor or in property shall be received unless such labor or property and the value thereof, so to be specified as aforesaid, be approved by said Board of Corporators." The Board of Corporators are two or more of the persons petitioning for the formation of the corporation; they are designated by the Secretary of State.

South Dakota. Section 8 of Art. XVII of the Constitution provides: "No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void."

See *Rogers* v. *Mining Company*, 21 S.D. 412 (1907).

Tennessee. Section 2335 of Shannon's Code, 1896, dealing with mining, quarrying, boring, and manufacturing companies, provides: "Nothing but cash shall be taken in payment of any part of the capital stock, or land at a fair cash valuation." But section 2351 provides: "Any manufacturing company hereafter or heretofore incorporated may receive the assignment of any patent in payment of any stock subscribed to the amount of the value of said patent, as

agreed on by the subscriber and the corporation." And see section 1 of chap. 474 of the Acts of 1903.

Section 1 of chap. 174 of the Acts of 1905 provides "that nothing but cash at not less than par valuation be received in payment for preferred stock."

Morrow v. *Iron & Steel Co.*, 87 Tenn. 262 (1889). Each subscriber was, by the terms of the subscription, to have bonds and also stock of the company, each to the amount of his subscription. A subscriber was obliged to pay for his stock, and the stipulation that he should also have bonds was treated as separable, and unenforcible.

Jones v. *Whitworth*, 94 Tenn. 602 (1895). A representative of creditors sought to fasten liability on persons to whom stock had been issued for land. The court held that an allegation that the property was "not conveyed at a fair cash value, but very far in excess of it" was so general as to be demurrable, and that it must be alleged and proved "that the property was sold at an overvaluation which was intentionally fraudulent, or which was so gross as to be constructively fraudulent, as against corporate creditors."

The court also held (p. 608) that all creditors — even those who had extended credit prior to the issue of stock — would be entitled to share in the amount recovered.

Texas. Section 6 of Art. XII of the Constitution provides: "No corporation shall issue stock or bonds except for money paid, labor done or property actually received, and all fictitious increase of stock or indebtedness shall be void."

Articles 1125 *et seq.* of the Revised Civil Statutes, 1911, provide that, before a corporation is chartered, the full amount of its authorized capital stock shall be subscribed, and fifty per cent be paid; that satisfactory evidence must be furnished to the secretary of state that the fifty per cent has been "paid in cash, or its equivalent in other property or labor done, the product of which shall be to the company of the actual value at which it was taken, or property actually received"; that the incorporators must submit to the secretary of state their affidavit showing "the cash value of any property received, giving its description, location and from whom and the price at which it was received, [and] the amount, character and value of labor done, from whom, and price at which it was received"; and that the secretary of state may require, at the expense of the incorporators, other and more satisfactory evidence than such affidavit. Certain corporations are exempted from these provisions. These provisions were enacted in 1907 (Acts of 1907, chap. CLXVI).

Mathis v. *Pridham*, 1 Tex. Civ. App. 58, 83 (1892). Persons to whom stock is issued at a discount are liable to creditors.

O'Bear-Nester Glass Co. v. *Antiexplo Co.*, 101 Tex. 431 (1908).

A corporation was formed in 1904. Stock was issued in payment of an unpatented secret formula of a compound to be mixed with gasoline, etc., to prevent explosion. Held, that this was not "property actually received" within the meaning of the Constitution, and that the persons who received the stock were liable to creditors of the corporation for the par value of their shares. But contract rights may be received in payment of stock. *Cole* v. *Adams*, 92 Tex. 171 (1898).

Cole v. *Adams*, 19 Tex. Civ. App. 507 (1898). The contention was made that holders of stock "issued for property at an overvaluation are not liable to creditors, as for unpaid stock, if said valuation was *bona fide* and without intent to defraud on the part of said corporation and those receiving the stock." The court said (p. 512): "While it is true this proposition is sustained by the decisions of courts of high respectability, we think the wiser and better rule is that, as to creditors without notice, property conveyed in payment of stock is not to be considered as a payment except to the extent of its money, or actual value."

Utah. Section 5 of Art. XII of the Constitution provides: "Corporations shall not issue stock, except to *bona fide* subscribers thereof or their assignee, nor shall any corporation issue any bond, or other obligation, for the payment of money, except for money or property received, or labor done. . . . All fictitious increase of stock or indebtedness shall be void."

Section 316 of the Compiled Laws, 1907, provides: "Where subscriptions to the capital stock of any corporation formed under the provisions of this chapter shall consist, in whole or in part, of property necessary to the pursuit agreed upon, there must appear in the articles of incorporation a description of the property so taken, with a statement of the fair cash value thereof, which statement, except in the case of corporations organized for mining or irrigating purposes, shall be supplemented by the affidavits of three persons, to the effect that they are acquainted with said property, and that it is reasonably worth the amount in cash for which it was accepted by the corporation; and the owners of such property shall be deemed to have subscribed such amount to the capital stock of such corporation as will represent the fair estimated cash value of so much of such property, or of such interest therein, as they may have conveyed to such corporation by deed actually executed and delivered."

Rolapp v. *Ogden R.R. Co.*, 37 Utah, 540 (1910). Bonds issued as a bonus, and which have not passed into the hands of *bona fide* purchasers, are unenforcible. The court said (p. 554): "If we keep in mind all of our own constitutional and statutory provisions, we think it is manifest that it was the intention both of the people who adopted the Constitution and the Legislature who passed the foregoing sections that the capital stock of corporations, excepting those

created for mining and irrigation, shall represent full actual value, either in money or property, and further that the subscribers for stock shall pay one hundred cents on the dollar, or its equivalent, for the stock subscribed for by them, and until so paid that they are liable to creditors of the corporation in a proper proceeding for any balance remaining unpaid on their subscriptions."

Henderson v. *Turngren*, 9 Utah, 432 (1893). If stock is issued in payment of conveyances of mining claims and properties in which the grantors had in fact no interest, the stockholders are liable to creditors. Evidence that the incorporators honestly thought the claims were valuable was rejected at the trial as immaterial. And see *Salt Lake Hardware Co.* v. *Tintic Milling Co.*, 13 Utah, 423 (1896).

Richardson v. *Mining Co.*, 23 Utah, 366 (1901). Stock of a mining corporation may be paid in mining property "at its estimated fair cash market value, whatever its actual cash value may be, and this is so even where the property has no ascertainable market value. The fixing of such value is a matter of opinion. It requires the exercise of judgment, and the exercise of judgment for such purposes, it is clear, the legislature left to the incorporators, where the corporation is organized for mining purposes. An opinion thus formed must be one honestly entertained, but it is subject to no other qualification."

Vermont. Section 19 of no. 141 of the Acts of 1915 provides: "Capital stock shall be issued only for (1) cash to the amount of each share of stock at par; or (2) real or personal property, rights or franchises at such value and to such an amount as may be determined by vote of the incorporators at a meeting held at the time of the organization of the corporation; and subsequent to such organization capital stock shall be so issued for said consideration at such value and to such an amount as may be determined by a vote of the stockholders. No stock shall be issued until after there has been filed with the secretary of state an affidavit executed by a majority of the incorporators or directors of the corporation, setting forth specifically (*a*) the amount of stock proposed to be issued; and (*b*) the property or consideration which is to be received for such stock; and (*c*) that in their judgment the property for which such stock is issued is actually worth in money the par value of such stock. The description of such property or consideration shall be sufficient in detail to satisfy the secretary of state that the same can be readily identified. Stock so issued shall be for all purposes full-paid stock and not liable to further call. An officer or director of a corporation who issues or consents to the issue of any shares of capital stock before having filed such affidavit, or who makes or consents to the making of any false statement in any such affidavit, shall be fined not more than one thousand dollars, or imprisoned not more than twelve months, or both."

[In 1915 the editor was employed by the state of Vermont to draft a General Corporation Act for submission to the Legislature. The provision, as to the issue of stock, which he recommended should be adopted was as follows: —

"Capital stock may be issued pursuant to the vote of the directors.

"Capital stock shall not be issued, directly or indirectly, except for (1) cash equal to the par value of the stock so issued; or (2) property other than cash (including patents, copyrights, franchises, privileges, contract rights, good will and other intangible property) of a value, ascertained as hereinafter provided, not less than the par value of the stock so issued; or (3) promotion expenses, to the extent hereinafter permitted.

"The governor and secretary of state and the state commissioner of taxes shall by virtue of their offices be commissioners of corporations.

"The market value of property is the amount of cash which such property would presently bring at a sale from a seller who desires to sell but is under no pressure to sell to a buyer who is able to pay in cash and who desires to buy but is under no pressure to buy.

"If stock is to be issued for property other than cash the corporation shall present a petition to the commissioners of corporations describing the property and asking for authority to issue a specified amount of stock for such property. An affidavit verified by at least three directors shall be annexed to such petition declaring that each of the subscribers to such affidavit (speaking for himself but not for the other subscribers) believes himself competent to appraise with substantial accuracy the market value, as defined in this act, of such property, and that he believes that the market value of such property is not less than the par value of the stock which the corporation seeks authority to issue.

"The commissioners may in their discretion employ competent persons to make an independent appraisal of the property. In such case they may fix the amount to be paid such appraisers for their services and expenses; but such amount shall not exceed one-half of one per cent of the par value of the stock which the corporation seeks authority to issue. If such par value amounts to more than fifty thousand dollars it shall not exceed a maximum to be agreed upon by the commissioners and the corporation before further proceedings relating to the petition are had. Such appraisers may in an action on this statute recover the amount so fixed from the corporation, or, if such amount is not paid by the corporation within thirty days after it is fixed by the commissioners, from the directors who subscribed such affidavit, and such directors shall be jointly and severally liable therefor.

"The commissioners may authorize such property to be received

in payment of an amount of stock to be specified by them in a writing under their seals, and they shall in such writing state the names and addresses of the independent appraisers, if any, who were employed. The petition, affidavit of directors, and such authorization shall be filed with, and recorded by, the secretary of state.

"A corporation may issue stock for promotion expenses, which shall include compensation to the promoters; the organization fee and the amount paid to appraisers under the provisions of this section within one year after it is formed; legal expenses relating to the formation of the corporation and the issue of stock issued within one year after it is formed; and the commission paid for underwriting its stock issued within one year after it is formed. The amount of stock issued for promotion expenses shall not, in any event, exceed twelve and one-half per cent of the whole amount of stock lawfully issued by the corporation within one year after it is formed.

"A corporation may carry its corporate franchise as an asset equal to the amount of stock issued for promotion expenses. But it shall annually mark off ten per cent of the value originally set upon such asset until it is no longer carried as an asset. These provisions shall not be held to fix the value of the corporate franchise, if it is taken by an exercise of the power of eminent domain.

"If stock is paid in cash but the cash or some part thereof is used, pursuant to any agreement or understanding had at the time such stock was paid in cash and with intent to evade the provisions of this section, in the payment of property or promotion expenses, so that, in substance, the stock is issued for such property or promotion expenses, all persons to whom or for whose benefit or account such stock was issued shall be jointly and severally liable to pay the corporation the difference between the par value of the stock and the actual value of the property, if any, for which, in substance, it was issued, with interest at ten per cent. Such amount may be recovered in an action or actions on this statute and no lapse of time shall bar the bringing of such action or actions."]

Virginia. Section 167 of the Constitution provides: "Whenever stock or bonds are to be issued by a corporation, it shall, before issuing the same, file with the State Corporation Commission a statement (verified by the oath of the president or secretary of the corporation, and in such form as may be prescribed or permitted by the commission) setting forth fully and accurately the basis, or financial plan, upon which such stock or bonds are to be issued; and where such basis or plan includes services or property (other than money), received or to be received by the company, such statement shall accurately specify and describe, in the manner prescribed, or permitted, by the commission, the services and property, together with the valuation at which the same are received or to be received."

By Subd. 9 of section 1105e of the Code, 1904, this constitutional provision is enacted, and it is further provided that "the judgment of the directors as to the value of such land or other property . . . in the absence of fraud, participated in by both parties to the transaction, shall be conclusive." For a violation of this provision a penalty may be imposed upon the corporation.

Martin v. *South Salem Land Co.*, 94 Va. 28 (1896). Persons to whom stock is issued at a discount are liable to creditors who extended credit without notice of the facts.

Monk v. *Barnett*, 113 Va. 635 (1912). The opinion in this case is set forth, *supra*.

Washington. Section 6 of Art. XII of the Constitution provides: "Corporations shall not issue stock, except to *bona fide* subscribers therefor, or their assignees; nor shall any corporation issue any bond or other obligation for the payment of money, except for money or property received or labor done. . . . All fictitious increase of stock or indebtedness shall be void."

As to mining corporations, see section 7347 of Remington & Balinger's General Statutes.

Cox v. *Dickie*, 48 Wash. 264 (1908). Persons to whom stock is issued at a discount are liable to creditors.

Lantz v. *Moeller*, 76 Wash. 429 (1913). Extracts from the opinion in this case are set forth, *supra*.

Adamant Mfg. Co. v. *Wallace*, 16 Wash. 614, 622 (1897). Creditors cannot complain who dealt with the corporation with knowledge of the facts.

West Virginia. Section 2253 of the Code, 1906, provides: "In no case shall stock be sold or disposed of at less than par, except by a vote of three-fourths of all the stock of the corporation outstanding at the time the vote is taken. . . . But nothing herein contained shall be so construed as to prevent any mining or manufacturing corporation subject to the provisions of this chapter, from issuing stock or bonds, and negotiating the sale of same, in payment of real and personal estate for the use of such corporation, and for its other corporate purposes and business, at such price and upon such terms and conditions as may be agreed upon by the owners and the directors or stockholders of such corporation. And any subscriber to the capital stock of any such mining or manufacturing corporation may pay for the same by the transfer and conveyance to such corporation of real or personal property, or both, proper or necessary for the uses and purposes of the corporation, upon such terms as may be mutually agreed upon. All stock so issued shall be fully paid and not liable to any further call or assessment, and, in absence of actual fraud in the transaction, the valuation of the property so

purchased shall be conclusive; but it shall be the duty of the corporation to have its minutes or other permanent records to show with reasonable detail the items of the property in payment for which stock or bonds were so issued."

Bank v. *Belington Coal Co.*, 51 W.Va. 60 (1902). Holders of stock issued for overvalued property are not liable to creditors, if no fraud has been practised upon the corporation. "Property should be purchased by corporations at reasonably fair valuation even if paid for in the capital stock of the company. But our statute throws the gate wide open for the sale of stock and purchase of property in payment therefor at such price and on such terms and conditions as contracting parties may agree upon" (p. 80). And see *In re Charles Town Light Co.*, 199 Fed. 846 (1912).

There was a *dictum* in *Bank* v. *Belington Coal Co.* that when stock is issued, at the formation of a corporation, "for cash at less than par, parties taking that stock are liable to creditors for the unpaid value thereof" (p. 80). And see *Security Trust Co.* v. *Ford*, 75 Ohio St. 322 (1906).

Wisconsin. Section 1753 of the Statutes, 1911, provides: "No corporation shall issue any stock or certificate of stock except in consideration of money or of labor or property estimated at its true money value, actually received by it, equal to the par value thereof, nor any bonds or other evidences of indebtedness except for money or for labor or property estimated at its true money value, actually received by it, equal to seventy-five per cent of the par value thereof, and all stocks and bonds issued contrary to the provisions of law and all fictitious increase of the capital stock of any corporation shall be void."

Gager v. *Paul*, 111 Wis. 638 (1901). A holder of stock which the corporation had agreed should be full-paid, although in fact only part had been paid, was held liable to creditors.

Gogebic Investment Co. v. *Iron Chief Mining Co.*, 78 Wis. 427 (1891). Persons to whom stock is issued for overvalued property are liable to creditors. The complaint alleged that the property was not worth 10 per cent of the par value of the stock, and that this fact was known to the stockholders when they received their stock. The case further held that if creditors extended credit to the corporation with knowledge of the facts, the burden of proving this was upon the stockholders. And see *Whitehill* v. *Jacobs*, 75 Wis. 474 (1890).

National Bank of Merrill v. *Illinois Lumber Co.*, 101 Wis. 247 (1898). If property is purchased for $20,000 and capitalized at $80,000, it is for the jury to say whether the stock is full-paid. "It must appear that the corporation and the stockholders fraudulently agreed that stock should be issued and property should be received therefor at a valuation substantially in excess of its real value for

the very purpose of creating apparently full-paid stock, and falsely holding the same out to the world as such. A gross and obvious over-valuation of property would be strong evidence of such fraud."

Wyoming. Section 3989 of the Compiled Statutes, 1910, provides: "The directors of such company may purchase mines, manufactories and other property necessary for their business, and issue stock to the amount of the value thereof in payment therefor, and the stock so issued shall be declared and taken to be full stock, and not liable to any further calls, neither shall the holders thereof be liable to any further payments [under other sections of the Statutes], but in all statements and reports of the company this stock shall not be stated or reported as being issued for cash paid into the company, but shall be reported in this respect according to the facts."

NOTE. — Statutes providing that public service corporations shall not issue stock without the approval of a public board are now common. See *Fall River Gas Co.* v. *Gas Commissioners*, 214 Mass. 529; *People* v. *Stevens*, 197 N.Y. 1; *People* v. *Stevens*, 203 N.Y. 7; *People* v. *Public Service Commission*, 203 N.Y. 299; *People* v. *Public Service Commission*, 210 N.Y. 456.

CHAPTER IV.

TRANSACTIONS BETWEEN PROMOTERS AND THE CORPORATION PROMOTED.

ERLANGER *v.* NEW SOMBRERO PHOSPHATE CO.

L.R. 3 A.C. 1218. 1878.

Appeal against a decision of the Court of Appeal which had reversed a decree of Vice-Chancellor Malins.

Sombrero, a small island in the West Indies, the property of the Crown, had been leased out by the Crown for twenty-one years from 1865. This lease had been assigned to "The Sombrero Company," which undertook to work the beds of phosphate of lime with which the island abounded. This company was ordered to be wound up. The lease was ordered to be sold by the official liquidator, Mr. Chatteris. Erlanger and others formed a syndicate to purchase it, and did purchase it for £55,000. The purchase was effected by a provisional contract August 30, 1871, though not formally concluded until later. The syndicate desired to resell the lease at a profit; and with that view proceeded to get up a company to purchase it from the syndicate.

Erlanger, who acted for the syndicate, took steps to form a company, under the Companies Act. A memorandum of association was drawn up by the solicitor of the syndicate, and was signed by seven persons all of whom were mere nominees of the syndicate. The articles of association for the company were drawn by the same solicitor, and bore date September 20, 1871. These articles provided that the first board of directors should consist of five specified persons; that two directors should be a quorum for the transaction of business; and that the directors might without any further authority from the members, adopt and carry into effect the contract, of even date, for the assignment to the company of the island of Sombrero for the residue of the term of the lease.

A contract had also been drawn up, and dated September 20, for the sale of the lease to the new company. This contract was between Evans as vendor and Pavy as purchaser on behalf of the new company. Evans was a trustee or agent for the members of the syndicate. The contract was, on the face of it, a provisional one, to the extent that it was subject to the formation of the company, and the

adoption of the contract by it. This contract recited the purchase by the syndicate on August 30, but did not name the price then given. The price to the new company was to be £110,000, of which £80,000 was to be paid in cash, and the remaining £30,000 to be satisfied by fully paid-up shares in the new company. The money was to be obtained by the subscriptions for the shares, which were to be 13,000 in number, of £10 each.

The five persons specified in the articles as directors were all named by the syndicate. Two of them were persons not likely to act, and who did not act, in the early proceedings of the board. The other three were Evans, Macdonald and Dakin. Evans's shares were given to him by Erlanger. Macdonald held shares only as trustee for Erlanger. Dakin had not sufficient knowledge of the facts to form an independent judgment. The first meeting of the directors was held September 29, 1871; and was attended by Evans, Macdonald and Dakin. It was resolved that the contract of purchase for £110,000 "be approved and confirmed." A prospectus was soon issued; and after its publication the number of applications for shares became considerable. On or before November 2, 1871, 30,000 full-paid shares and £80,000 in cash were issued or paid by the company to the vendors.

There was never any confirmation of the purchase by vote of the stockholders.

Subsequently, after new directors had been chosen, the bill in this suit was filed by the company against Erlanger and all the members of the syndicate; one prayer being that the contract of September 20 might be set aside, and the purchase money repaid to the company.

The case was heard before Vice-Chancellor MALINS, who ordered the bill to be dismissed, but without costs. On appeal by the company, the contract was ordered to be rescinded as to all members of the syndicate, the purchase money paid by the company repaid, and, on payment of the money so ordered to be repaid to the company, the island was to be restored by the company to the syndicate.

Erlanger *et al.* then brought the present appeal to the House of Lords.

The case was twice argued.

LORD PENZANCE. Can a contract so obtained be allowed to stand? The bare statement of the facts is, I think, sufficient to condemn it. From that statement I invite your Lordships to draw two conclusions: first, that the company never had an opportunity of exercising, through independent directors, a fair and independent judgment upon the subject of this purchase; and, secondly, that this result was *brought about by the conduct* and contrivance of the vendors themselves. It was the vendors, in their character of promoters, who had the power and the opportunity of creating and forming the

company in such a manner that with adequate disclosures of fact, an independent judgment on the company's behalf might have been formed. But instead of so doing they used that power and opportunity for the advancement of their own interests. Placed in this position of unfair advantage over the company which they were about to create, they were, as it seems to me, bound according to the principles constantly acted upon in the Courts of Equity, if they wished to make a valid contract of sale to the company, to nominate independent directors and fully disclose the material facts. The obligation rests upon them to shew they have not made use of the position which they occupied to benefit themselves; but I find no proof in the case that they have discharged that obligation. There is no proof that either Sir Thomas Dakin or Admiral Macdonald was aware of the price at which the property had just been brought under the authority of the Court of Chancery, nor, indeed, that they even knew that the real vendors were also the promoters of the company. And there is certainly no proof that in the selection of the directors who were to be the company's agents for accepting and affirming the proposed purchase, the vendors used their power as promoters in such a way as to create an independent body capable of acting impartially in defence of the company's interests.

A contract of sale effected under such circumstances is, I conceive, upon principles of equity liable to be set aside.

The principles of equity to which I refer have been illustrated in a variety of relations, none of them perhaps precisely similar to that of the present parties, but all resting on the same basis, and one which is strictly applicable to the present case. The relations of principal and agent, trustee and *cestui que trust*, parent and child, guardian and ward, priest and penitent, all furnish instances in which the Courts of Equity have given protection and relief against the pressure of unfair advantage resulting from the relation and mutual position of the parties, whether in matters of contract or gift; and this relation and position of unfair advantage once made apparent, the Courts have always cast upon him who holds that position, the burden of shewing that he has not used it to his own benefit.

LORD CAIRNS. It is now necessary that I should state to your lordships in what position I understand the promoters to be placed with reference to the company which they proposed to form. They stand, in my opinion, undoubtedly in a fiduciary position. They have in their hands the creation and moulding of the company; they have the power of defining how, and when, and in what shape, and under what supervision, it shall start into existence and begin to act as a trading corporation. If they are doing all this in order that the company may, as soon as it starts into life, become, through its managing directors, the purchaser of the property of themselves, the promoters, it is, in my opinion, incumbent upon the promoters to

take care that in forming the company they provide it with an executive, that is to say, with a board of directors, who shall both be aware that the property which they are asked to buy is the property of the promoters, and who shall be competent and impartial judges as to whether the purchase ought or ought not to be made. I do not say that the owner of property may not promote and form a joint-stock company, and then sell his property to it, but I do say that if he does he is bound to take care that he sells it to the company through the medium of a board of directors who can and do exercise an independent and intelligent judgment on the transaction, and who are not left under the belief that the property belongs, not to the promoter, but to some other person. . . . I cannot but regard a meeting at which two of the principal directors did not and could not attend, at which one who did attend and take part in the deliberations was at once a person buying and selling, where the legal adviser present and assisting was virtually another vendor, and where the two remaining directors are not shewn to have had the means of exercising, or to have exercised, any intelligent judgment on the subject, as little else than a mockery and a delusion.

ATTORNEY-GENERAL FOR CANADA *v.* STANDARD TRUST CO.

[1911] A.C. 498.

VISCOUNT HALDANE. In this appeal the question which has to be decided is whether the appellant, the Attorney-General for the Dominion of Canada, can successfully object to a claim by the respondents to be admitted as creditors of the South Shore Railway Company for a sum of $348,000. The material facts of the case are these: —

In the year 1893 a railway, extending from St. Lambert, opposite Montreal, to Sorel, a distance of about forty-five miles, had been built, and belonged to the Montreal and Sorel Railway Company. Bonds for 100*l.* each had been issued by the company to the extent of about 1500. The company had become bankrupt and the railway was not being worked. On March 1 in that year Messrs. Tourville, Leduc, Fortier, and Beauchemin agreed to form themselves into a syndicate for the purpose of acquiring the railway and of completing and equipping it and putting it into good condition. They bought up 1453 of the bonds at a price amounting to about 34,000*l.* They also bought up a judgment against the company for a substantial sum, and they spent a good amount of their own money in improving the railway. Under an Act of the Quebec Legislature, assented to on January 8, 1894, a company known as the South Shore Railway

Company was incorporated, with power to construct and acquire railways in the locality of the Montreal and Sorel Railway. This Act and the incorporation under it of the South Shore Company were procured by the four members of the syndicate. The whole of the shares in the company in reality belonged to them, and there were no independent shareholders. Each of them subscribed for $75,000 of the company's stock. Along with three other persons, nominees whom they had qualified, they were elected directors, and Mr. Tourville was elected president. On January 16 a meeting of the shareholders was held, at which the directors were authorized to enter into agreements with railway companies and with other persons in accordance with the provisions of the Act. On June 1, 1894, the Montreal and Sorel Railway was sold by the Sheriff of Montreal under a judgment obtained by the Collector of Taxes, and it was bought, at a nominal price of $1600, by Mr. Tourville, a member of the syndicate, and the president of the South Shore Company. On June 4, at a meeting of the directors, Mr. Tourville, on the narration that the real value of the railways was represented by the bonds of the Montreal and Sorel Company acquired by the members of the syndicate and by them transferred in part to the South Shore Company in payment for the stock they had subscribed for, agreed to transfer the railway to the South Shore Company at a purchase price to be settled at a later period. The deed of sale to the company from the sheriff was executed on July 7. On October 8, 1895, the directors and their nominees, the only persons interested in the company, fixed the sale price at $648,000, and took credit in their own favour for the $300,000 subscribed by the members of the syndicate and paid in bonds as already stated. This price has not been shewn to be excessive, although it amounted to much more than the syndicate had actually spent in acquiring and improving the railway. The indebtedness of the company, after taking credit for the $300,000 of subscription money, thus amounted to $348,000, and this sum was allocated as an indebtedness of $87,000 to each of the four members of the syndicate, with interest at 6 per cent. A formal agreement to this effect between the members of the syndicate and the South Shore Company was executed on December 2, 1895. These debts were subsequently transferred to the respondents.

In 1902 the South Shore Railway Company was amalgamated with the Quebec Southern Railway Company. In 1904, the companies having become insolvent and having failed to work the railways, the Minister of Railways and Canals for the Dominion of Canada instituted proceedings in the Exchequer Court of Canada, under the provisions of the Canadian statute 3 Edw. 7, c. 21, against the amalgamated companies for a sale. Under the provisions of this and a subsequent statute passed for the purpose, a sale was ordered on September 11, 1905, and the railways were sold for $1,051,000.

By a subsequent order it was referred to the referee of the Court to investigate the claims of the creditors of the companies. The respondents put in a claim on the basis above indicated. The Attorney-General of the Dominion, as an unsecured creditor of the amalgamated railway companies, intervened and contested this claim, as did also the Bank of St. Hyacinthe.

The case put forward by the Attorney-General, the present appellant, and by the bank, was that the proceedings of the members of the syndicate as directors of the South Shore Company, authorizing the purchase of the Montreal and Sorel Railway and the transfer of bonds in payment for the stock subscribed for by the syndicate, was ultra vires and a breach of duty. It was said that Mr. Tourville and his associates in the syndicate were promoters of the South Shore Company and occupied a fiduciary position towards it, and that the resolution of the directors fixing the price of the railway at $648,000 was not binding and that the price was unfair. The respondents' answer was that the price was not in excess of the real value, and that the Attorney-General and the bank had no title to object.

The referee, after hearing evidence and argument, by his final report, dated May 25, 1908, dismissed the case of the Attorney-General and the bank and allowed the claim of the respondents. The Attorney-General and the bank both moved to vary this report, but the Exchequer Court, by order dated October 31, 1908, dismissed the motions. From this order the Attorney-General and the bank both appealed to the Supreme Court of Canada, which, by a judgment dated February 15, 1910, dismissed the appeals, IDINGTON, J., dissenting. The Attorney-General alone now appeals to the Privy Council.

The appellant contends, on the footing of being an unsecured creditor of the Quebec Southern Railway Company as amalgamated, that the fund arising from the sale directed by the Exchequer Court ought not to be diminished by admitting the claim of the respondents. He alleges that the price of $648,000 paid in 1894 to the syndicate for the railway was excessive, that the transaction was ultra vires, and that, apart from this, the members of the syndicate, being also directors, were in a fiduciary position towards the South Shore Company, such that the transaction cannot stand. In the view of the case taken by their Lordships, it is not necessary to enter into the question whether the price of $648,000 was excessive. The referee, after hearing evidence, decided that it was not, and this finding of fact is not dissented from by any of the judges in the Courts below, except IDINGTON, J. But whatever may have been the character of this transaction, it was approved, with full knowledge of the facts, by all of those who owned, or were beneficially interested in, the stock of the company at the time. It, therefore, does not matter, for the purposes of a case such as the present, that these

persons were also promoters and vendors. If the transaction had been ultra vires in the sense of being outside the legal capacity of the company, and accordingly not its act, the case would have been different. But, although this has been suggested, their Lordships can find no foundation for the argument. Under the provisions of the statute of the Quebec Legislature incorporating it, the company had power to purchase the Montreal and Sorel Railway, and was authorized to take payment for the amount subscribed for its stock in bonds of any railway company. The transaction was actually carried out in this form, and was on the face of it within the powers conferred by the statute on the company. If, therefore, what the directors did is to be impeached, it must be on the ground, not of its having been ultra vires of the company, but of its having been a breach of duty by the directors. Now, although the capital of the company was $1,000,000, the only stock issued was to the amount of $300,000, and this was taken up and owned by the members of the syndicate and no one else. They and they alone were interested in the capital of the company. This is not a case of winding up, but even if it were, it would make no difference. In proceedings of the character of the present the title of a liquidator as representing creditors cannot be higher than the title of the company against whom the creditors claim. In this case the interests of the company and of the syndicate were identical. The only persons beneficially interested in the company were the four members of the syndicate. The law gave them the complete control of its action. Under that control the company gave effect to the policy of the only persons who had any beneficial interest in its capital. The case is not one in which the apparent procedure can be said to have been unreal, or to have been a cloak under which a conspiracy to defraud was concealed. Under these circumstances, their Lordships are of opinion that the company, notwithstanding that no general meeting, apart from the meeting of directors, appears to have been held for the purpose, was completely bound by the transactions sought to be impeached, and that the appellant, who has certainly no title higher than that of the company against the assets of which he claims, is bound likewise.

In the course of the argument for the appellant the well-known case of *Erlanger* v. *New Sombrero Phosphate Co.*, 3 App. Cas. 1218, was much relied on, as shewing that the action of the directors could not stand. It is sufficient to observe that, for the reasons given in the House of Lords in *Salomon* v. *Salomon* [1897], A.C. 22, the doctrine of the former case has no application to circumstances such as those of the present case, where every one interested in the capital of the company has, with full knowledge, concurred in the act impeached. Their Lordships will humbly advise His Majesty that the appeal should be dismissed. The costs must be paid by the appellant.

OLD DOMINION COPPER CO. *v.* LEWISOHN.

210 U.S. 206. 1908.

MR. JUSTICE HOLMES delivered the opinion of the court.

This is a bill in equity brought by the petitioner to rescind a sale to it of certain mining rights and land by the defendants' testator, or in the alternative to recover damages for the sale. The bill was demurred to and the demurrer was sustained. 136 Fed. Rep. 915. Then the bill was amended and again demurred to, and again the demurrer was sustained, and the bill was dismissed. This decree was affirmed by the Circuit Court of Appeals. 148 Fed. Rep. 1020; 79 C.C.A. 534. The ground of the petitioner's case is that Lewisohn, the deceased, and one Bigelow, as promoters, formed the petitioner that they might sell certain properties to it at a profit, that they made their sale while they owned all the stock issued, but in contemplation of a large further issue to the public without disclosure of their profit, and that such an issue in fact was made. The Supreme Judicial Court of Massachusetts has held the plaintiff entitled to recover from Bigelow upon a substantially similar bill. 188 Massachusetts, 315.

The facts alleged are as follows: The property embraced in the plan was the mining property of the Old Dominion Copper Company of Baltimore, and also the mining rights and land now in question, the latter being held by one Keyser, for the benefit of himself and of the executors of one Simpson, who with Keyser owned the stock of the Baltimore company. Bigelow and Lewisohn, in May and June, 1895, obtained options from Simpson's executors and Keyser for the purchase of the stock and the property now in question. They also formed a syndicate to carry out their plan, with the agreement that the money subscribed by the members should be used for the purchase and the sale to a new corporation, at a large advance, and that the members, in the proportion of their subscriptions, should receive in cash or in stock of the new corporation the profit made by the sale. On May 28, 1895, Bigelow paid Simpson's executors for their stock on behalf of the syndicate, in cash and notes of himself and Lewisohn, and in June Keyser was paid in the same way.

On July 8, 1895, Bigelow and Lewisohn started the plaintiff corporation, the seven members being their nominees and tools. The next day the stock of the company was increased to 150,000 shares of twenty-five dollars each, officers were elected, and the corporation became duly organized. July 11, pursuant to instructions, some of the officers resigned, and Bigelow and Lewisohn and three other absent members of the syndicate came in. Thereupon an offer was received from the Baltimore company, the stock of which had been

bought, as stated, by Bigelow and Lewisohn, to sell substantially all its property for 100,000 shares of the plaintiff company. The offer was accepted, and then Lewisohn offered to sell the real estate now in question, obtained from Keyser, for 30,000 shares, to be issued to Bigelow and himself. This also was accepted and possession of all the mining property was delivered the next day. The sales "were consummated" by delivery of deeds, and afterwards, on July 18, to raise working capital, it was voted to offer the remaining 20,000 shares to the public at par, and they were taken by subscribers who did not know of the profit made by Bigelow and Lewisohn and the syndicate. On September 18, the 100,000 and 30,000 shares were issued, and it was voted to issue the 20,000 when paid for. The bill alleges that the property of the Baltimore company was not worth more than $1,000,000, the sum paid for its stock, and the property here concerned not over $5,000, as Bigelow and Lewisohn knew. The market value of the petitioner's stock was [not] less than par, so that the price paid was $2,500,000, it is said, for the Baltimore company's property and $750,000 for that here concerned. Whether this view of the price paid is correct, it is unnecessary to decide.

Of the stock in the petitioner received by Bigelow and Lewisohn or their Baltimore corporation, 40,000 shares went to the syndicate as profit, and the members had their choice of receiving a like additional number of shares or the repayment of their original subscription. As pretty nearly all took the stock, the syndicate received about 80,000 shares. The remaining 20,000 of the stock paid to the Baltimore company, Bigelow and Lewisohn divided, the plaintiff believes, without the knowledge of the syndicate. The 30,000 shares received for the property now in question they also divided. Thus the plans of Bigelow and Lewisohn were carried out.

The argument for the petitioner is that all would admit that the promoters (assuming the English phrase to be well applied) stood in a fiduciary relation to it, if, when the transaction took place, there were members who were not informed of the profits made and who did not acquiesce, and that the same obligation of good faith extends down to the time of the later subscriptions, which it was the promoters' plan to obtain. It is an argument that has commanded the assent of at least one court, and is stated at length in the decision. But the courts do not agree. There is no authority binding upon us and in point. The general observations in *Dickerman* v. *Northern Trust Co.*, 176 U.S. 181, were *obiter*, and do not dispose of the case. Without spending time upon the many dicta that were quoted to us, we shall endeavor to weigh the considerations on one side and the other afresh.

The difficulty that meets the petitioner at the outset is that it has assented to the transaction with the full knowledge of the facts. It is said, to be sure, that on September 18, when the shares were issued

to the sellers, there were already subscribers to the 20,000 shares that the public took. But this does not appear from the bill, unless it should be inferred from the ambiguous statement that on that day it was voted to issue those shares "to persons who had subscribed therefor," upon receiving payment, and that the shares "were thereafter duly issued to said persons," etc. The words "had subscribed" may refer to the time of issue and be equivalent to "should have subscribed" or may refer to an already past event. But that hardly matters. The contract had been made and the property delivered on July 11 and 12, when Bigelow, Lewisohn and some other members of the syndicate held all the outstanding stock, and it is alleged in terms that the sales were consummated before the vote of July 18 to offer the stock to the public had been passed.

At the time of the sale to the plaintiff, then, there was no wrong done to any one. Bigelow, Lewisohn and their syndicate were on both sides of the bargain, and they might issue to themselves as much stock in their corporation as they liked in exchange for their conveyance of their land. *Salomon* v. *Salomon & Co.* [1897], A.C. 22; *Blum* v. *Whitney*, 185 N.Y. 232; *Tompkins* v. *Sperry*, 96 Maryland, 560. If there was a wrong it was when the innocent public subscribed. But what one would expect to find, if a wrong happened then, would not be that the sale became a breach of duty to the corporation *nunc pro tunc*, but that the invitation to the public without disclosure, when acted upon, became a fraud upon the subscribers from an equitable point of view, accompanied by what they might treat as damage. For it is only by virtue of the innocent subscribers' position and the promoter's invitation that the corporation has any pretense for a standing in court. If the promoters after starting their scheme had sold their stock before any subscriptions were taken, and then the purchasers of their stock with notice had invited the public to come in and it did, we do not see how the company could maintain this suit. If it could not then, we do not see how it can now.

But it is said that from a business point of view the agreement was not made merely to bind the corporation as it then was, with only forty shares issued, but to bind the corporation when it should have a capital of $3,750,000; and the implication is that practically this was a new and different corporation. Of course, legally speaking, a corporation does not change its identity by adding a cubit to its stature. The nominal capital of the corporation was the same when the contract was made and after the public had subscribed. Therefore what must be meant is, as we have said, that the corporation got a new right from the fact that new men who did not know what it had done had put in their money and had become members. It is assumed in argument that the new members had no ground for a suit in their own names, but it is assumed also that their position changed that of the corporation, and thus that the indirect effect of

their acts was greater than the direct; that facts that gave them no claim gave one to the corporation because of them, notwithstanding its assent. We shall not consider whether the new members had a personal claim of any kind, and therefore we deal with the case without prejudice to that question, and without taking advantage of what we understand the petitioner to concede.

But, if we are to leave technical law on one side and approach the case from what is supposed to be a business point of view, there are new matters to be taken into account. If the corporation recovers, all the stockholders, guilty as well as innocent, get the benefit. It is answered that the corporation is not precluded from recovering for a fraud upon it, because the party committing the fraud is a stockholder. *Old Dominion Copper Mining and Smelting Co.* v. *Bigelow*, 188 Massachusetts, 315, 327. If there had been innocent members at the time of the sale, the fact that there were also guilty ones would not prevent a recovery, and even might not be a sufficient reason for requiring all the guilty members to be joined as defendants in order to avoid a manifest injustice. *Stockton* v. *Anderson*, 40 N.J. Eq. 486. The same principle is thought to apply when innocent members are brought in later under a scheme. But it is obvious that this answer falls back upon the technical diversity between the corporation and its members, which the business point of view is supposed to transcend, as it must, in order to avoid the objection that the corporation has assented to the sale with full notice of the facts. It is mainly on this diversity that the answer to the objection of injustice is based in *New Sombrero Phosphate Co.* v. *Erlanger*, 5 Ch. D. 73, 114, 122.

Let us look at the business aspect alone. The syndicate was a party to the scheme to make a profit out of the corporation. Whether or not there was a subordinate fraud committed by Bigelow and Lewisohn on the agreement with them, as the petitioner believes, is immaterial to the corporation. The issue of the stock was apparent, we presume, on the books, so that it is difficult to suppose that at least some members of the syndicate, representing an adverse interest, did not know what was done. But all the members were engaged in the plan of buying for less and selling to the corporation for more, and were subject to whatever equity the corporation has against Bigelow and the estate of Lewisohn. There was some argument to the contrary, but this seems to us the fair meaning of the bill. Bigelow and Lewisohn, it is true, divided the stock received for the real estate now in question. But that was a matter between them and the syndicate. The real estate was bought from Keyser by the syndicate, along with his stock in the Baltimore company, and was sold by the syndicate to the petitioner along with the Baltimore company's property, as part of the scheme. The syndicate was paid for it, whoever received the stock. And this means that two-fifteenths

of the stock of the corporation, the 20,000 shares sold to the public, are to be allowed to use the name of the corporation to assert rights against Lewisohn's estate that will enure to the benefit of thirteen-fifteenths of the stock that are totally without claim. It seems to us that the practical objection is as strong as that arising if we adhere to the law.

Let us take the business point of view for a moment longer. To the lay mind it would make little or no difference whether the 20,000 shares sold to the public were sold on an original subscription to the articles of incorporation or were issued under the scheme to some of the syndicate and sold by them. Yet it is admitted, in accordance with the decisions, that in the latter case the innocent purchasers would have no claim against any one. If we are to seek what is called substantial justice in disregard of even peremptory rules of law, it would seem desirable to get a rule that would cover both of the almost equally possible cases of what is deemed a wrong. It might be said that if the stock really was taken as a preliminary to selling to the public, the subscribers would show a certain confidence in the enterprise and give at least that security for good faith. But the syndicate believed in the enterprise, notwithstanding all the profits that they made it pay. They preferred to take stock at par rather than cash. Moreover, it would have been possible to issue the whole stock in payment for the property purchased, with an understanding as to 20,000 shares.

Of course, it is competent for legislators, but not, we think, for judges, except by a *quasi*-legislative declaration, to establish that a corporation shall not be bound by its assent in a transaction of this kind, when the parties contemplate an invitation to the public to come in and join as original subscribers for any portion of the shares. It may be said that the corporation cannot be bound until the contemplated adverse interest is represented, or it may be said that promoters cannot strip themselves of the character of trustees until that moment. But it seems to us a strictly legislative determination. It is difficult, without inventing new and qualifying established doctrines, to go behind the fact that the corporation remains one and the same after once it really exists. When, as here, after it really exists, it consents, we at least shall require stronger equities than are shown by this bill to allow it to renew its claim at a later date because its internal constitution has changed.

To sum up: In our opinion, on the one hand, the plaintiff cannot recover without departing from the fundamental conception embodied in the law that created it; the conception that a corporation remains unchanged and unaffected in its identity by changes in its members. *Donnell* v. *Herring-Hall-Marvin Safe Co.*, 208 U.S. 267, 273; *Salomon* v. *Salomon & Co.* [1897], A.C. 22, 30. On the other hand, if we should undertake to look through fiction to facts, it

appears to us that substantial justice would not be accomplished, but rather a great injustice done, if the corporation were allowed to disregard its previous assent in order to charge a single member with the whole results of a transaction to which thirteen-fifteenths of its stock were parties, for the benefit of the guilty, if there was guilt in any one, and the innocent alike. We decide only what is necessary. We express no opinion as to whether the defendant properly is called a promoter, or whether the plaintiff has not been guilty of laches, or whether a remedy can be had for a part of a single transaction in the form in which it is sought, or whether there was any personal claim on the part of the innocent subscribers, or as to any other question than that which we have discussed.

The English case chiefly relied upon, *Erlanger* v. *New Sombrero Phosphate Co.*, 3 App. Cas. 1218, affirming *S.C.*, 5 Ch.D. 73, seems to us far from establishing a different doctrine for that jurisdiction. There, to be sure, a syndicate had made an agreement to sell, at a profit, to a company to be got up by the sellers. But the company, at the first stage, was made up mainly of outsiders, some of them instruments of the sellers, but innocent instruments, and, according to Lord CAIRNS, the contract was provisional on the shares being taken and the company formed (p. 1239). There never was a moment when the company had assented with knowledge of the facts. The shares, with perhaps one exception, all were taken by subscribers ignorant of the facts, 5 Ch.D. 113, and the contract seems to have reached forward to the moment when they subscribed. As it is put in 2 Morawetz, Corp. (2d ed.) § 292, there was really no company till the shares were issued. Here thirteen-fifteenths of the stock had been taken by the syndicate, the corporation was in full life and had assented to the sale with knowledge of the facts before an outsider joined. There most of the syndicate were strangers to the corporation, yet all were joined as defendants (p. 1222). Here the members of the syndicate, although members of the corporation, are not joined, and it is sought to throw the burden of their act upon a single one. *Gluckstein* v. *Barnes* [1900], A.C. 240, certainly is no stronger for the plaintiff, and in *Yeiser* v. *United States Board & Paper Co.*, 107 Fed. Rep. 340, another case that was relied upon, the transaction equally was carried through after innocent subscribers had paid for stock. *Decree affirmed.*

DAVIS *v.* LAS OVAS CO.

227 U.S. 80. 1912.

MR. JUSTICE LURTON. This is a bill by the appellee to recover from appellants secret profits made by them as promoters of the Las Ovas Company in the purchase of a part of a tract of land known

as Las Ovas in the Republic of Cuba, and also for the cancellation of certain shares of stock issued to them as promoters.

The facts essential to judgment are not in serious dispute. They are found clearly and fully stated in the opinion by Mr. Justice GOULD of the Supreme Court of the District of Columbia, and again in the opinion of the Court of Appeals of the District by Mr. Justice ROBB.

From the facts found by both courts it appears: —

a. That the appellants and certain other persons, not parties to this suit, signed an agreement on March 19, 1904, by which they agreed to purchase for a corporation which they were to organize a specified part of a tract of land in Cuba called the Las Ovas plantation, for the price of $34,000, to which it was later agreed to add another small parcel at an additional price of $1,000.

b. It was further agreed that they should organize a corporation, of which they should be the incorporators, with a capital stock of $150,000, and that 40 per cent of the shares should be issued to them for service as promoters and that the remaining stock should be subscribed for by them. For this subscribed stock they were to pay an amount sufficient to cover the purchase money of $35,000 and to create an expense fund of $5,000.

c. It was agreed that the property should, when acquired, be placed in the hands of one of the group of promoters until the formation of the company, and then conveyed to it.

d. The scheme was one originated and engineered by the appellants, who at the time of this agreement had already secretly secured an option for themselves for the purchase of this property at the price of $20,000. To conceal the true consideration from their associates they caused the property to be conveyed by the vendor to one Escalante, a stranger selected by them. The deed to Escalante recited the true consideration. Later, in pursuance of the promoters' agreement, they caused Escalante to convey to the member of the syndicate selected to hold the title until organization, reciting a consideration of $35,000.

The corporation was organized as planned. The promoters' shares were duly issued and the remaining shares taken by the promoters upon the agreed terms, its officers and directors being composed exclusively of the members of the syndicate. Thereupon the property was transferred to the company and paid for, through appellants, out of the proceeds of the subscribed stock.

The result of the transaction was that the corporation was required to pay to those who had assumed to act for and represent it, a secret profit of fifteen thousand dollars and also to compensate them for their services in buying the land and organizing the company by issuing to each of them fifteen thousand dollars in non-assessable shares of its stock.

The decree below required the appellants to account for the profits realized by them, in part traced to certain shares in their hands, and to surrender for cancellation the shares issued to them as promoters.

It is now said that the corporation was "a mere convenient receptacle for the property, erected for the convenience of the syndicate." That the property was bought by the syndicate for their own advantage and that the corporation included only the members of the syndicate. That the stock of the company was all taken by the syndicate, who, for property which was their own, agreed to pay enough to cover the purchase price and create a small expense fund.

Upon this contention it is urged that the corporation has no right to the relief sought, as the whole transaction was a mere form adopted by the parties for their own convenience as owners of the property and owners of the corporation. It is then said: "If we admit, for the purposes of this point, that appellants did deceive some of the syndicate, what has the company to do with it?" For this they cite *Old Dominion Copper Company* v. *Lewisohn*, 210 U.S. 206, where it was held that a subordinate fraud practiced by some of the promoters of a corporation upon some of their associates was a matter wholly between them and the syndicate which gave rise to no corporate right of action in the absence of innocent incorporators or stockholders.

But that is not this case. Some of those, if not all, interested by appellants in the property and in its purchase for a proposed consideration were ignorant of the real price which they were to pay for it, and were not, therefore, in complicity with their scheme to make a secret profit. These innocent members of the syndicate became stock subscribers and directors of the company, as did appellants. The buyers and sellers were not the same. Those of the syndicate assuming to act for the corporation in acquiring the property were under obligation to disclose the truth and deal openly. In the absence of such disclosure the corporate assent was obtained on false grounds. The wrong was done when those members of the syndicate not in complicity with appellants subscribed to the stock of the company and aided their guilty associate managers in the corporate action necessary to the corporate acquisition of the property at the exaggerated price placed upon it by those who were to realize a secret profit. Thus, the original fraud practiced upon some of those associated with them in the promoters' arrangement became operative against the corporation itself. The standing of the corporation results from the fact that there were innocent and deceived members of the corporation when the property was taken over by it.

Neither is the corporate right of action defeated by the fact that the recovery will inure to the guilty as well as to the innocent, nor is the fact that all of the parties who may have shared in the secret

profits are not sued fatal to the case. The corporation may well sue either one or all of those who received secret profits. There is no want of necessary parties because all are not here sued.

The distinction between a case in which all of the owners of the property and all of the members of the buying corporation are the same persons, and participate in the profit realized, and the case here presented is fully recognized in *Old Dominion Copper Company* v. *Lewisohn, supra,* as well as in *Phosphate Company* v. *Erlanger,* 5 Ch. Div. 73, and in the well considered opinion of Judge SEVERENS in *Yeiser* v. *U.S. Paper Co.,* 107 Fed. Rep. 340.

There was no error in cancelling the shares issued to the plaintiffs in error for promotion of the corporation. They and the other members of the syndicate received these shares upon the assumption that they had in good faith served the corporation in the procurement of the property. Obviously appellants were serving themselves to the detriment of the corporation and innocent subscribers to its stock. In such a situation the corporation may recover the shares.

The decree will be affirmed.

OLD DOMINION COPPER CO. *v.* BIGELOW.

203 Mass. 159. 1909.

RUGG, J. These are suits in equity, by which the plaintiff seeks to recover secret profits made by the defendant as one of its organizers, in selling to it while under the absolute control and management of himself and his associate, one Lewisohn, certain mining properties belonging to him and Lewisohn. The allegations of the bills are set out at length in 188 Mass. 315, where one of the cases was considered upon demurrer. After the overruling of the demurrer the defendant answered, and the cases were heard before a single justice, who entered decrees in favor of the plaintiff in both cases and filed a report of the facts found by him. Except as to matters immaterial so far as the questions of law are involved, he found that the allegations were sustained. Briefly recapitulated, the facts appearing in the report upon which the plaintiff rests its claim are that in April, 1895, the defendant and Lewisohn formed a device to secure the control of the stock (the par value of which was $500,000) of the Old Dominion Copper Company of Baltimore City, called the Baltimore Company, and the title to certain other neighboring mining properties, called the outside properties, and to cause these properties and the real estate of the Baltimore Company to be transferred to a new corporation (which they should procure to be organized with a much larger capital), for an increased price. Options were secured upon these properties, and the price agreed to be paid by the de-

fendant and Lewisohn to the owners was $1,000,000, divided in the proportion of 547/1000 by the defendant, and 453/1000 by Lewisohn. The outside properties were regarded by all parties as of little or no value and were thrown in as a makeweight in the purchase of the stock of the Baltimore Company. The single justice, while finding that they could not be said to be of no value, was satisfied that their value did not exceed $50,000. No examination to ascertain their value was made by the defendant or Lewisohn, or by any one in behalf of the plaintiff. For the purpose of providing himself with funds to meet in part his financial obligations for the purchase of the properties, the defendant, before taking up the options, organized an underwriting syndicate and another syndicate called the Old Dominion Syndicate. It is not necessary to state the details of these arrangements, further than to say that it is found as a fact that the defendant did not deal fairly with the members of the syndicate in the division of his profits, and did not disclose to the great majority of them the fact of the secret profit. The obligation of purchase was assumed wholly by the defendant and Lewisohn, and the device for the organization of the new corporation was entirely theirs. Although, as first conceived, it was the avowed intention of the defendant and Lewisohn (which the defendant expressed to various members of the syndicate) to form a new corporation with a capital stock of $2,500,000 which should take the property of the Baltimore Company and the outside properties for $2,000,000 of its capital stock and procure a working capital of $500,000 by the sale of the rest of the capital stock to the public for cash at par, they proceeded to organize the plaintiff corporation under the laws of New Jersey, with a capital stock of $3,750,000, divided into one hundred and fifty thousand shares of the par value of $25 each. But it was the intention of the defendant and Lewisohn (as found by the single justice) that "twenty thousand shares of the capital stock of the plaintiff should be issued to new subscribers at par; and this was done in the summer and fall of 1895." This organization was conducted and controlled wholly by the defendant and Lewisohn through themselves and their agents and representatives. Without providing the plaintiff with an independent board of officers or representatives they, as the responsible and only managers of the plaintiff, acting in its name, contracted with themselves as mine owners to sell to it the real estate of the Baltimore Company for $2,500,000 of the capital stock of the plaintiff and the outside properties, of trifling value at best, for $750,000 of such capital stock, and to sell to the general public for working capital the remaining $500,000 of capital stock of the plaintiff at par, without disclosing that they had sold property costing them only $1,000,000 for three and a quarter times its cost.

The first meeting of the stockholders was held on July 7, 1895,

at which $1,000, — the lowest amount of capital with which a corporation organized under the laws of New Jersey could begin business, — was paid in by Lewisohn. This money, although deposited to the credit of the plaintiff company upon its organization, was afterwards returned by it to Lewisohn in an accounting with him. A meeting of the directors was held in New York on July 11, 1895, at which the defendant became a director and the president of the plaintiff and Lewisohn a director. Votes were passed to increase the capital stock and two separate votes for the purchase of the mining properties for the prices in stock before indicated. The stock, the market value of which was fully as great as its par value, was issued to the defendant and Lewisohn and one Dumaresq, their nominee, by votes of September 18, 1895, on that or the following day. At the same time a certificate for the remaining twenty thousand shares of stock of the par value of $500,000 was made out in the name of "Thomas Nelson, treasurer," but this stock is found to have belonged to the corporation, and Nelson had no right to act respecting it, as it was taken up by direct subscriptions of the public. The conveyances of the mines by the Baltimore Company and of the outside properties by Lewisohn were not made until December, 1895, or January, 1896. The intrinsic value of the property conveyed by the Baltimore Company is found to have been not more than $1,000,000, although its market value, largely due to the skilful manipulation of the defendant and Lewisohn, and "the ingenious manner in which they created a desire on the part of men interested in mines, as investors or speculators, to be allowed to join in the transaction they were carrying out," was something less than $2,000,000. The report proceeds: "But, taking the most favorable view of the situation possible for the defendant, he and Lewisohn did, by reason of their failure to disclose the real facts as aforesaid, make out of their sale to the plaintiff company a secret profit of fifty thousand shares of its capital stock, of which the defendant's portion was twenty-seven thousand three hundred and fifty shares, and Lewisohn's portion was twenty-two thousand six hundred and fifty shares. If he had fully disclosed the facts to the plaintiff company and secured for it independent advice, it would not have given to him this secret profit; . . . Lewisohn and he were acting in the formation and execution of the scheme together and in concert. Each of them was doing his part to carry out a joint scheme, which was intended to inure to the advantage of both. The control exercised by them over the plaintiff company was a joint control, and was exercised by them for the benefit of both. A proper disclosure of the real facts by either would have frustrated the schemes of both; they both acted together in pursuance of a common design, and for the profit of both." "During all these transactions the full control of the plaintiff company was in the hands of and was exercised by the defendant and

Lewisohn, who were its promoters and who themselves determined upon and dictated, under the advice of their counsel, everything that was done by the plaintiff company or in its behalf; it had no directors, representatives, or advisers other than themselves or their agents; and they did not disclose to it any of the facts which have been stated. This continued to be the case until April, 1902. . . .

"The result of his and Lewisohn's transactions with the plaintiff company was that for the $1,000,000 of their own and their associates' money which they invested, they received, subject to the payment of legitimate expenses of not over $20,000, stock to the par value of $3,250,000, and of the actual value of at least that amount: that is, at the rate of more than three dollars for one. He gave to the members of his syndicate two dollars for one, either wholly in stock or half in cash and half in stock, as they elected. With a few individual exceptions he did not disclose the facts to them. The very great majority of the members of his syndicate did not become aware of the details of what he and Lewisohn had done." The capital stock issued to defendant and Lewisohn was stamped "Issued for property purchased." The law of New Jersey required that such stock be issued only "to the amount of the value" of the property so purchased. Pub. Laws of New Jersey, 1889, p. 414, § 4; 1893, p. 444, § 2. The vote of July 11, 1895, to purchase the mining properties was in fact passed by a majority only of the board of directors, for three do not appear to have been present at that time. At the directors' meeting of September 18, 1895, when the votes to issue thirty thousand full paid shares to the defendant and Lewisohn and one hundred thousand like shares to their nominee Dumaresq were passed, seven directors were present, the five aside from Bigelow and Lewisohn being their tools, and at the end of the record of that meeting all the directors signed an assent to the acts done, and Bigelow and Lewisohn, signing for thirty thousand shares of capital stock, Dumaresq signing for one hundred thousand shares of the capital stock, and "Thomas Nelson, Treasurer," signing for twenty thousand shares of capital stock, being the whole number of shares, signified a written approval of the acts of that meeting. The single justice found that the twenty thousand shares were the property of the plaintiff, and that Nelson had no right to attempt to act as their holder. . . .

The next inquiry is as to the liability of the defendant. The plaintiff seeks to establish this on the ground that the defendant and Lewisohn framed a scheme, which was an entirety and which as a whole comprised the organization and continued management of the plaintiff by themselves, their agents and representatives, until the completion of the project; this scheme was the capitalization of the plaintiff for $3,750,000; the sale to it of their property, costing and intrinsically worth $1,000,000, but having in the market a value not

over $2,000,000, for $3,250,000; the sale to the general public at par for cash of the remaining $500,000 of stock; and all this without providing the plaintiff with any independent board of officers or advisers to pass upon the wisdom of the purchase and without disclosing the substance of the transaction and their extraordinary profit to the purchasers of its stock for cash at par. This scheme was an entity, one part of it was just as essential as any other part, and one part was the procurement of $500,000 in cash from the unenlightened public as a working capital for the new company.

It has been decided, apparently by a unanimous court, that such a transaction creates a liability on the part of the defendant to account for his profits to the plaintiff in this proceeding. *Hayward* v. *Leeson*, 176 Mass. 310. One of the present suits was before the court as reported in 188 Mass. 315, and after an elaborate review of the authorities and examination of the grounds for judgment, it was held that the defendant was liable, notwithstanding the opposing decision on the precise point by the United States Circuit Court in *Old Dominion Copper Mining & Smelting Co.* v. *Lewisohn*, 136 Fed. Rep. 915. Since the decision reported in 188 Mass. 315, the above entitled case against Lewisohn has been considered by the United States Circuit Court of Appeals (148 Fed. Rep. 1020) and by the Supreme Court of the United States (210 U.S. 206) and without dissent a conclusion has been reached contrary to that of this court. The deference due to a decision by the highest court in the land and the intrinsic importance of the question at issue require a reconsideration of our own cases, a re-examination of the authorities and a careful consideration of the principles involved.

The plaintiff seeks to recover a secret profit made by the promoters in the sale of their own property to the corporation, basing its claim on the general and well recognized proposition that a promoter cannot take lawfully a secret profit and will be held to account for it if he does. Fundamentally the action is to recover profits obtained by a breach of trust. There is a distinct finding by the single justice that the defendant and Lewisohn were the promoters of the plaintiff. This finding is amply justified by the evidence. In their brains it was conceived, by their direction the formalities of its incorporation were carried out, their resources provided its mines, their influence and reputation with those desiring to invest in mines procured its working cash capital. The word "promoter" has no precise and inflexible meaning in this country. In England it is defined by statute. St. 7 & 8 Vict. c. 110, § 3. See also St. 30 & 31 Vict. c. 131, § 38. But even there the duties of promoters as fiduciaries to the company are matters of common law cognizance. *Erlanger* v. *New Sombrero Phosphate Co.*, 3 App. Cas. 1218, 1269. In a comprehensive sense "promoter" includes those who undertake to form a corporation and to procure for it the rights, instru-

mentalities and capital by which it is to carry out the purposes set forth in its charter, and to establish it as fully able to do its business. Their work may begin long before the organization of the corporation, in seeking the opening for a venture and projecting a plan for its development, and may continue after the incorporation by attracting the investment of capital in its securities and providing it with the commercial breath of life. It is now established without exception that a promoter stands in a fiduciary relation to the corporation in which he is interested, and that he is charged with all the duties of good faith which attach to other trusts. In this respect he is held to the high standards which bind directors and other persons occupying fiduciary relations.

That the promoter stands in the relation of a fiduciary to the corporation which he organizes seems to be conceded in *Old Dominion Copper Mining & Smelting Co.* v. *Lewisohn*, 210 U.S. 206. The questions to be answered are, whether this rule is applicable, and if it is, whether the plaintiff is in a position to assert its claim.

Notwithstanding this fiduciary relation the promoter may sell property to the company which he is promoting. But in order that the contract may be absolutely binding he must pursue one of four courses: (*a*) He may provide an independent board of officers in no respect directly or indirectly under his control, and make full disclosure to the corporation through them; (*b*) He may make a full disclosure of all material facts to each original subscriber of shares in the corporation; (*c*) He may procure a ratification of the contract after disclosing its circumstances by vote of the stockholders of the completely established corporation; (*d*) He may be himself the real subscriber of all the shares of the capital stock contemplated as a part of the promotion scheme. The defendant does not contend upon this report that either of the first two courses was followed. He does rest his claim chiefly upon the third and fourth courses. As applied to the facts of this case these two come to the same thing, for the reason that on the findings of the single justice the defendant and his associate were subscribers for only one hundred and thirty thousand shares out of a total one hundred and fifty thousand and in the light most favorable to them they held all the shares which had been issued at the time of the ratification, but not all which it was proposed to issue as a part of the scheme of promotion. The point to be determined, therefore, is whether the promoter is immune from liability if he and his associates are owners of all the issued stock at the time of the act complained of, although intending as a part of their plan the immediate issue of further stock to the public without disclosure, and whether, while a substantial portion of the stock intended to be issued to the public remains unissued, a vote of ratification of the breach of trust will protect him.

A review of the authorities seems to demonstrate that there is a

liability of the promoter to the corporation when further original subscribers to capital stock, contemplated as an essential part of the scheme of promoters, came in after the transaction complained of, even though that transaction is known to all the then stockholders, that is to say, to the promoters and their representatives.

Erlanger v. *New Sombrero Phosphate Co.*, 3 App. Cas. 1218, is one of the most important and thoroughly considered cases, and, as it has been said to be a case often misunderstood (Lord DAVEY in *Salomon* v. *Salomon* [1897], A.C. 22, 57), it is well to consider it at length. It was first heard by Vice-Chancellor MALINS under the name of *New Sombrero Phosphate Co.* v. *Erlanger* (5 Ch.D. 73), then by the justices of appeal (5 Ch.D. 102), and finally by the House of Lords, where it was twice argued. The facts were these: Erlanger and his associates, hereafter spoken of as the syndicate, bought of the official liquidator of a broken down company the lease of a phosphate island, for £55,000. The agreement for purchase was signed on September 11, and was subject to the approval of the judge, which was given on September 15, 1871. By its terms the contract was to be completed on November 15, 1871. The syndicate then organized the New Sombrero Phosphate Company under St. 25 & 26 Vict. c. 89 (3 App. Cas. 1264). The articles of association of the new corporation were signed on September 20, 1871, and the company registered on September 20 or 21 (5 Ch.D. 76). On registration the corporation was created under 25 & 26 Vict. c. 89, § 18 of which provided that upon registration "the subscribers . . . shall thereupon be a body corporate . . . capable forthwith of exercising all the functions of an incorporated company." The signers of the articles of association were tools of the syndicate. The members of the first board of directors were named in the articles of association. Two were out of the country and would not attend meetings; others were an employee of Erlanger, a retired admiral of the English navy, whose shares necessary to qualify him as a director were paid for by Erlanger (5 Ch.D. 107, 108), and the mayor of London; three directors made a quorum, and the last three named attended the meetings. The syndicate anticipated its payments required by its contract and acquired the lease of the island on September 21, 1871. The first meeting of the directors was held on September 29, 1871, at which was produced and approved by resolution an agreement between one Evans (in whose name in behalf of the syndicate the contract for the purchase of the lease from the official liquidator was made), and one Pavy (acting for the new company), dated September 20, whereby Evans sold and Pavy for the company bought the lease of the island for £80,000 in cash and £30,000 in paid up stock. In the discussion of this case in 210 U.S. at p. 216 this contract is stated to have been "provisional on the shares being taken and the company formed," but we do not so understand it as

set forth in 5 Ch.D. 75, 76 and 95. It was subject to the new company being registered (which was done on September 20 or 21), and to the contract with the official liquidator being approved by the judge (which was done on September 15) and duly performed (which was done on September 21) and to the confirmation by the company (which was given by vote of the directors on September 29, who were in this regard clothed by the articles of association with all the authority of the corporation itself, 3 App. Cas. 1273, 1274), but it contained no other provisional features. The directors adopted the contract between Evans and Pavy without investigation into its merits, and in ignorance of the profit made by the syndicate except as Evans had such knowledge. After this the public over-subscribed. The stock was issued, £30,000 to the syndicate and £100,000 to the public; and on November 2 £80,000 was paid to the syndicate by the company. 5 Ch.D. 96. Respecting this agreement for sale by the syndicate it is further said in 210 U.S. at p. 217, that "the contract seems to have reached forward to the moment when they [the public] subscribed. As it is put in 2 [1 is meant] Morawetz, Corp. (2d ed.) § 292, there was really no company till the shares were issued," and on this ground it is stated by the court at p. 216 that the English case "seems to us far from establishing a different doctrine for that jurisdiction." We cannot accede to this interpretation. The company was fully formed the moment it was registered. The subscription for the shares required as a prerequisite to registration under the English statute established the company as fully as the forty shares subscribed and the $1,000 for capital stock, paid into the plaintiff's treasury on or before July 11, 1895, established it. It was enabled to make any contract within the scope of its powers. That is settled by the plain language of 25 & 26 Vict. c. 89, § 18, quoted above. But it also has been expressly so decided. It was said in *Salomon* v. *Salomon* [1897], A.C. 22, at p. 51: "When the memorandum is duly signed and registered, though there be only seven shares taken, the subscribers are a body corporate 'capable forthwith,' to use the words of the enactment, 'of exercising all the functions of an incorporated company.' Those are strong words. The company attains maturity on its birth. There is no period of minority — no interval of incapacity." This apparently demonstrates the error of the further statement in 1 Morawetz, Corp. (2d ed.) 279, that "Before any shares were issued the existence of the corporation was a fiction." The remark of Lord CAIRNS (3 App. Cas. at p. 1239) to the effect that the contract for the sale of the island was "provisional on the shares being taken and the company completely formed" was made in connection with the defense of laches and not in the discussion as to the liability of the defendants (which he had concluded on an earlier page), and refers only to the fact that the scheme of the defendants to get £80,000 in cash out of the new

company under their contract with it was dependent as a practical matter on the shares being taken by the public, and does not and cannot apply to the phraseology of the contract itself, for respecting that it is not correct. The only conditions named in the contract were that the company should be registered and confirm the contract and the contract of the syndicate with the official liquidator be performed. (See 5 Ch.D. 75, 76 and 95.) The distinction which appears to be established between the Erlanger case and the present one, by the decision of the United States Supreme Court, 210 U.S. 206, is that if promoters organize a company with a capital of $3,750,000 and sell to it through their dummy directors property bought by them for this purpose, for $3,250,000, in paid up shares, and then get by public subscription $500,000 for working capital, the transaction is valid. But if promoters, having bought property for £55,000, organize a company with a capital of £130,000, and while they are the only *bona fide* stockholders by vote of their directors sell to it their property for £110,000, to be paid £80,000 in cash and £30,000 in paid up shares, £100,000 being subscribed in cash by the public, the transaction is void. The only difference between the two cases is that in the Erlanger case the promoters were paid a part of the purchase price in money, the proceeds of public subscription, and received paid up shares, which they took in payment of the balance of the purchase price when the stock was issued to subscribers, while in the present case the whole purchase price was paid in stock, which was issued before any stock was issued to the public although after a substantial public subscription. In other words, the order in which the transaction is carried out, and not its substantial nature, makes the difference between liability and immunity of the promoter. It is true that in the Erlanger case, until after ratification by the company of the contract previously made in its behalf for the purchase of the lease of the island, the mayor of London by acting as a director was liable to take shares of stock and intended to, and did subsequently, take and pay for fifty shares. He and possibly one other (3 App. Cas. 1228) appear to have been the only persons up to that time connected with the company, who subsequently became stockholders, who were not agents of the promoters. But it is also the fact (as stated by Jessel, M.R., in 5 Ch.D. at p. 112) that "Up to this time there was not really a single *bona fide* shareholder distinct from the promoters," and of course all these assented to the transaction. If this is a vital circumstance, that case is distinguishable in principle from the one at bar and from the case decided by the United States Supreme Court. This appears to us to be a difference upon an immaterial matter. It is of no consequence whether in fact the dummy directors know of the terms of sale and the breach of trust of the promoters. It does not appear in the present case that the nominees of Bigelow and Lewisohn knew any more about the

profit the latter were making than did the directors of the New Sombrero Company of the profits of the syndicate. The point is that in both cases the directors were selected with the purpose that they should be the mere instruments of the promoters, and they carried out the will of their masters. Under the English statute the instruments of the promoters in the New Sombrero Company, while its directors, were as fully clothed with all the powers of the corporation and as much the holders of all its stock as were the seven directors of the plaintiff holding in all forty shares of the plaintiff at the time the contract of sale in the present case was made. If the assent of all the stockholders is good in the one case, by the same token it should be equally good in the other; and the breach of trust in the one is equally a breach of trust in the other. This case seems to us an authority in favor of the plaintiff.

In *New Sombrero Phosphate Co.* v. *Erlanger*, 5 Ch.D. 73, 123, it was said by BAGGALLAY, L.J.: "The syndicate were, in substance, not only the vendors of the property, but also the promoters of the company, and in such a case the syndicate, as promoters, being in a fiduciary relation to the company, it was essential that the public, who were invited to become, and who were expected to become, the shareholders of the company, and to constitute the company, should have the fullest information as to all the surrounding circumstances." See also JESSEL, M.R., s.c. at p. 113. In *In re British Seamless Paper Box Co.*, 17 Ch.D. 467, at p. 471, it was said by JESSEL, M.R.: "If promoters make an arrangement to get a profit for themselves out of what is apparently paid to the vendors, it is immaterial whether the contract with the vendors is approved of by the directors of the company, who are the promoters, just before the allotment or just after: in both cases it is intended to cheat the future shareholders; and of course it makes no difference whatever that the persons who, at the time the allotment was made, were in fact the promoters or their nominees, knew of the fraud. You can defraud future allottees as well as present allottees." In the same case on appeal COTTON, L.J., said (17 Ch.D. at p. 479): "The directors stand in a fiduciary relation to the whole company, that is, not only to the existing members but to all whom they intend to bring in." In *Broderip* v. *Salomon* [1895], 2 Ch. 323, at p. 329, it was said by VAUGHAN WILLIAMS, J. (whose conclusion was approved in s.c. *sub nomine Salomon* v. *Salomon* [1897], A.C. 22): "Of course, purchasing at an exorbitant price may be a fraud, even if all the shareholders know of it, if there is an intention to allot further shares at a later period to future allottees." This point was apparently left open in the House of Lords [1897], A.C. at p. 37. In *In re Leeds & Hanley Theatres of Varieties* [1902], 2 Ch. 809, at p. 823, occurs this language: "At first there were only four directors . . . and the seven necessary signatories of the memorandum of the association. When it is said that the promoters

stood in a fiduciary position towards the company, that does not mean that they stood in such a relation to these directors and these seven signatories. It means that they stood in a fiduciary relation to the future allottees of shares — to the persons who were invited to come and take up the shares of the company." In *Gluckstein* v. *Barnes* [1900], A.C. 240, 257, Lord ROBERTSON says: "The people for whom these gentlemen [the promoters] were bound to act were their coming constituents, the persons out of whose money they proposed to make their gain." In *Densmore Oil Co.* v. *Densmore*, 64 Penn. St. 43, at p. 50, it is said: "Where persons form such an association, or begin or start the project of one, from that time they do stand in a confidential relation to each other, and to all others who may subsequently become members or subscribers, and it is not competent for any of them to purchase property for the purposes of such a company, and then sell it at an advance without a full disclosure of the facts." This language is quoted with approval and applied in *Burbank* v. *Dennis*, 101 Cal. 90, 98, and in *South Joplin Land Co.* v. *Case*, 104 Mo. 572, 580. To the same point, *Pittsburg Mining Co.* v. *Spooner*, 74 Wis. 307, 321–323. In *Pietsch* v. *Milbrath*, 123 Wis. 647, at p. 656, it is held that "Persons who act as promoters of a corporation do not necessarily cease to be such when the corporation is organized to do business. . . . So long as there are prospective original subscribers for stock and the promoters and those concerting with them remain in control of the corporation, it is in a position to be deceived. . . . It is deceived in a legal sense when it is rendered helpless by its managers as to protecting those invited to subscribe for its stock, and is then used to aid in defrauding them." This is supported by *Fred Macey Co.* v. *Macey*, 143 Mich. 138, 152, a case singularly like the one at bar in its essential features, where relief was granted to the corporation against the promoters although they subscribed for all the capital stock. Other cases which in principle reach the same result are *Yeiser* v. *United States Board & Paper Co.*, 107 Fed. Rep. 340, 348; *London Trust Co.* v. *Mackenzie*, 62 L.J. Ch. (N.S.) 870; *Hinkley* v. *Sac Oil & Pipe Line Co.*, 132 Iowa, 396. It was said in *Groel* v. *United Electric Co.*, 4 Robbins, 616, 622: "There can be no question that promoters are liable to the corporation for profits secretly made by them in its promotion, and that such liability arises in cases where future allottees of stock are concerned. *Knoop* v. *Bohmrich*, 4 Dick. 82. *Plaquemines Tropical Fruit Co.* v. *Buck*, 7 Dick. 219. *Loudenslager* v. *Woodbury Heights Land Co.*, 13 Dick. 556, affirming the principle established in the court of chancery in *Woodbury Heights Land Co.* v. *Loudenslager*, 10 Dick. 78." In *Central Trust Co.* v. *East Tennessee Land Co.*, 116 Fed. Rep. 743, and *Camden Land Co.* v. *Lewis*, 101 Maine, 78, 95, *Hayward* v. *Leeson*, 176 Mass. 310, to this point is cited with approval. *St. Louis, Fort Scott & Wichita Railroad* v.

Tiernan, 37 Kans. 606, and *Stewart* v. *St. Louis, Fort Scott & Wichita Railroad*, 41 Fed. Rep. 736, were both decided on the assumption that the promoters took all the stock, although it appears that later some stock was issued to municipalities through which the tracks of the promoted railroad corporation ran, but whether as a part of the original plan of promotion does not appear, and no weight is attached to this circumstance in the opinions. Numerous other cases which have been cited do not bear upon this point for the reason that in each of them the owners of the property conveyed have owned either the entire capital stock of the corporation or all that it was contemplated to issue. See *Foster* v. *Seymour*, 23 Fed. Rep. 65; *McCracken* v. *Robison*, 57 Fed. Rep. 375; *Barr* v. *New York, Lake Erie & Western Railroad*, 125 N.Y. 263; *Blum* v. *Whitney*, 185 N.Y. 232. *In re Ambrose Lake Tin & Copper Mining Co.*, 14 Ch.D. 390; *Salomon* v. *Salomon* [1897], A.C. 22; *In re British Seamless Paper Box Co.*, 17 Ch.D. 467; *Seymour* v. *Spring Forest Cemetery Association*, 144 N.Y. 333; *Hutchinson* v. *Simpson*, 92 App. Div. (N.Y.) 382; *Tompkins* v. *Sperry*, 96 Md. 560; *Langdon* v. *Fogg*, 18 Fed. Rep. 5; *Flagler Engraving Machine Co.* v. *Flagler*, 19 Fed. Rep. 468; *Insurance Press* v. *Montauk Fire Detecting Wire Co.*, 103 App. Div. (N.Y.) 472; *Higgins* v. *Lansingh*, 154 Ill. 301; *In re Baglan Hall Colliery Co.*, L.R. 5 Ch. 346. In all these cases it was also true that no shares were ever issued (so far as appears) other than those to the promoters, except that in *In re British Seamless Paper Box Co.*, 17 Ch.D. 467, at a time considerably subsequent to the organization of the corporation, a change in the scheme was made in good faith by which others were brought in as subscribers.

In this respect the question is one of intention of the promoters. If they actually intend at the time the company is brought out to remain its sole owners and that it shall not receive the money of innocent shareholders in the future, then although thereafter the exigencies of the company may be such as to require the issue of additional stock, they may not be responsible. *In re British Seamless Paper Box Co.*, 17 Ch.D. 467, is an illustration of this principle. There it was found that the promoters were and intended to remain the sole proprietors of the property of the company and the sole members of the company. COTTON, L.J., at p. 479, said: "Here it is an established fact that when the company was formed it was intended to be a private company, that is, it was intended to carry it on without calling in the public, or issuing any shares except to the then existing shareholders. Therefore the doctrine that directors may not take a profit for themselves is inapplicable, because all the members knew that they intended to make a profit. It is true that some new members were subsequently taken in. If shortly after this transaction a prospectus had been issued and the public had been invited to come in and take shares, no court would have listened to

directors who said that it was not intended to take in fresh members. But this was commenced and carried on entirely as a private company, and a considerable time elapsed before they asked any one to join them."

In *Wills* v. *Nehalem Coal Co.*, 52 Ore. 70, a corporation was organized by promoters with a capital of $150,000. More than half was issued to promoters and their tools in return for property of one of them conveyed at an overvaluation. Afterwards shares were sold to the public without disclosure of the great profit made by promoters. Relief was granted. The contention that the corporation had assented with full knowledge of the facts by all who were the stockholders at the time of the sale was disposed of on the ground that in substance a wrong was done the corporation in diminishing the common fund held for the benefit of all the stockholders by issuing a part of its capital stock for property worth less than its face value. In *Richlands Oil Co.* v. *Morriss*, 108 Va. 288, the facts as stated in the opinion were that the promoters, having acquired the control of certain oil leases for an insignificant price, "proceeded to transfer these leases to a company which they organized upon a capitalization of 1,000,000 shares (the par value of each share being $1), and distributed 600,000 of those shares to themselves; and having perfected the organization of the company by making themselves the president, secretary, treasurer, and directors undertook to market the residue of the shares of stock, amounting to 400,000, without informing the public as to the true condition of affairs." The suit of the corporation was upheld. Upon the point we are now discussing these two cases are indistinguishable in principle from the cases at bar.

This review of decisions seems to establish abundantly the proposition that promoters stand in a fiduciary position toward the corporation, as well when as a part of the scheme of promotion uninformed stockholders are expected to come in after the wrong has been perpetrated, as when at that time there are shareholders to whom no disclosure is made. We find no authority opposed except the Lewisohn cases in the federal courts (210 U.S. 206).

If the question is examined on principle apart from authority, the same result appears clear. The starting point is that a promoter is a fiduciary to the corporation. To use the words of Lord CAIRNS in *Erlanger* v. *New Sombrero Phosphate Co.*, 3 App. Cas. 1218, at p. 1236: Promoters "have in their hands the creation and moulding of the company: they have power of defining how, and when, and in what shape, and under what supervision, it shall start into existence and begin business." The corporation is in the hands of the promoter like clay in the hands of the potter. It is to this person, absolutely helpless and incapable of independent initiative or uncontrolled action, that the promoter stands as trustee. It is not neces-

sary to inquire how far he may be trustee also for shareholders or associates. In the present case the inquiry relates wholly to his obligation to the corporation. The fiduciary relation must in reason continue until the promoter has completely established according to his plan the being which he has undertaken to create. His liability must be commensurate with the scheme of promotion on which he has embarked. If the plan contemplates merely the organization of the corporation his duties may end there. But if the scheme is more ambitious and includes beside the incorporation, not only the conveyance to it of property but the procurement of a working capital in cash from the public, then the obligation of faithfulness stretches to the length of the plan. It would be a vain thing for the law to say that the promoter is a trustee subject to all the stringent liabilities which inhere in that character and at the same time say that, at any period during his trusteeship and long before an essential part of it was executed or his general duty as such ended, he could, by changing for a moment the cloak of the promoter for that of director or stockholder, by his own act alone, absolve himself from all past, present or future liability in his capacity as promoter. The plaintiff was fully organized and authorized to do business on July 8 and 11, 1895, when only $1,000 in capital stock had been paid in. It would be an idle ceremony indeed to establish for promoters the obligations of trustees, and at the same time hold that by their tools and with only $1,000 paid in, and that as a mere form (for it was soon after repaid to one of them) they could vote to themselves a wholly unwarranted profit of $1,250,000, kept secret from other initial shareholders, because at that moment they were the only stockholders. By such a course the law would be holding out apples of Sodom to the wronged corporation. Corporations can be formed through irresponsible agents with ease. If these agents can vote away a substantial part of the capital stock for property of comparatively small value, and still with immunity to themselves and their principals receive from the uninformed public cash subscriptions for the rest of the capital stock, the organization and management of corporations might readily become a "system of frauds." *Peabody* v. *Flint*, 6 Allen, 52, 55. It is answered that the plaintiff has assented to the transaction with full knowledge of the facts. But it has not assented when it stood where it could act independently. The assent to the wrongful act of the promoters was given at the behest and by vote of the promoters themselves, while still occupying the position of protectors to their own creature, while it was bound hand and foot by them and prevented from taking any action except through them as a step in its further exploitation, and while their trust was uncompleted. The corporation although by law fully organized was still in its swaddling clothes, so far as the plans of the promoters were concerned. The value of their stock taken in return

for their mining property was dependent in a substantial degree upon the corporation having $500,000 in cash for a working capital. They could not perfect their plans nor reap their contemplated profit, except by retaining their hold upon the corporation until the public had made this contribution. In one sense it is true that the plaintiff was completely organized on July 11 and on September 20, 1895. It was fully competent to be bound by its contracts and ratification of contracts with those dealing with it at arm's length. But it was not free from its wardship to its promoters, whose scheme from the first looked forward to a corporation with treasury filled by subscriptions from the unenlightened public. The corporation was not dealing with these fiduciaries upon an independent ground. The plaintiff, although a legal corporation from July 8, leaned wholly upon its promoters, because they made it so to lean, until long after the events here in controversy. An assent under these conditions can be of no greater effect than the assent of a minor under guardianship to the breaches of trust of his guardian.

The situation is akin to the conveyance of property by a man solvent but in contemplation of insolvency. Such conveyance is not wrong until the contemplated indebtedness is incurred which makes him an insolvent. Then the executed evil intent stretches back and invalidates the original conveyance. Here the conveyance to the corporation with the secret profit, when there are no uninformed subscribers to stock, if nothing more is ever done, is not an actionable tort. But the vicious intent looks forward to the procurement of money from the ignorant public by means of original subscriptions and the execution of this evil intent extends backward to contaminate the sale and its profit.

Stress has sometimes been laid upon the fact that the promoters were paid a part of their purchase price out of the public subscriptions. But there is no difference in principle between such a case and the present, where a substantial part of the value of the stock taken by the defendant and Lewisohn depended upon the cash subscriptions to be made by the public for the remaining shares not issued to the promoters.

But it is further argued that, the entire capital stock outstanding at the time being in the hands of the promoters, the sale of the property to the corporation was merely changing the form of title of the promoters from owners of real estate to that of shares of stock, and that, there being then no other shareholders, no wrong was done. It has been decided that where persons own the entire authorized capital stock of the company and take it in payment for the conveyance of their property at a grossly exaggerated price, nobody can be heard to complain. The leading English cases upon this point are *In re Gold Co.*, 11 Ch.D. 701, *In re Ambrose Lake Tin & Copper Mining Co.*, 14 Ch.D. 390, *In re British Seamless Paper Box Co.*, 17 Ch.D.

467, and *Salomon* v. *Salomon* [1897], A.C. 22. But these and many other like cases cited on pages 185 and 186 *ante* are where the promoters owned all the outstanding capital stock and intended to remain the sole proprietors and did not purpose that there should be, as a part of the promotion plan, a substantial issue of stock for cash to the public. This is pointed out in *London Trust Co.* v. *Mackenzie*, 62 L.J. Ch. (N.S.) 870, 875. The distinction is clear between cases of that class and those like the present, where the promoters took for themselves a large number of shares of stock without adequate consideration and without disclosure to the detriment of the corporation and all its future shareholders, at the same time planning that there should be immediate public subscriptions. It is one thing to take all the shares of a corporation in payment for physical property conveyed. It does not much matter to the stockholders in such a case whether the total is one hundred and thirty thousand shares or one hundred and fifty thousand shares. But it is a very different thing to take $\frac{130,000}{150,000}$ of capital stock of a corporation whose assets consist of the same physical property, and in addition \$500,000 in money subscribed by others. The latter course affects the other stockholders and the corporation itself, and it gives the promoters something appreciably more valuable than what they contribute. It is true that in *Salomon* v. *Salomon* and in some other cases there was a part of the authorized capital stock which was not issued, but it was not proposed to be issued as a part of the scheme of promotion and the original shareholders intended to remain the only shareholders. It was to be issued or not in the remote future, as the exigencies of the corporation in the actual conduct of its business might require, but, in any event, it was not to be issued for the purpose of starting the corporation on its course. This circumstance materially affects the question here to be considered. Most, if not all, corporation laws provide in some form for an increase of capital stock. It is of no consequence upon such a point as this, whether the capital stock originally authorized is large but not all issued or whether it is at first small and subsequently an increase is authorized. This seems to be the view taken by the English courts, for it is said by JAMES, L.J., in *In re British Seamless Paper Box Co.*, 17 Ch.D. 467, "If they [the promoters] were intending, although then constituting the whole company, that other people should come in afterwards to whom what had been done would be injurious, the court would feel no difficulty in saying as Lord LANGDALE did in *Society of Practical Knowledge* v. *Abbott,* 2 Beav. 559, that they intended to commit a fraud."

The fundamental reasoning upon which these cases can rest is not that no wrong has been committed, but there is no one to enforce the remedy. All courts recognize the soundness of the doctrine that no man can be on both sides of the same bargain with justice to all

interests. The principle that one cannot rightfully sell property, belonging to him in his private right, to himself in a trust capacity is universal.

If this aspect alone is looked at and the corporation is regarded as a distinct person, it cannot be said that the corporation is not wronged by such a breach of duty by promoters. It is only when the corporate personality is disregarded and its component elements as stockholders alone are considered that it can be said that no harm is done on the ground (as was said in *Salomon* v. *Salomon* [1897], A.C. at p. 57) that "the company is bound in a matter *intra vires* by the unanimous agreement of its members." But looking through the form of the corporation to the stockholders and treating them as the corporation is an exception to the otherwise firmly established universal rule that the corporation is a separate legal entity for all purposes, even though all its stock be held by a single interest and it be to all practical intents merely the instrument of the stockholder. *Conley* v. *Mathieson Alkali Works*, 190 U.S. 406. *Peterson* v. *Chicago, Rock Island & Pacific Railway*, 205 U.S. 364, 390. We perceive no reason for extending this exception to a case like the present.

The real ground of the decisions of which *Salomon* v. *Salomon* is a type is that the corporation is estopped by the circumstance that all persons with financial concern in the matter have assented with knowledge, and thus the lips of everybody are sealed. It is not that no wrong has been done, but that whatever wrong has been done has been condoned. The maxim "*Volenti non fit injuria*" is invoked. This, however, is setting up confession and avoidance and not a bar to the main cause of action.

The theory upon which corporations are founded is that they are artificial persons, distinct and separate from officers and stockholders. Corporate liabilities do not attach to the latter. The wrong which the defendant and his associate did in this case was in selling property worth intrinsically $1,000,000 and in the market at most $2,000,000 for $3,250,000 without revealing that they were making a secret profit. The wrong was done to the corporation. It affected all its shareholders, present and future alike. It is generally admitted that if there are existing stockholders ignorant of the wrong, redress may be had. But it is had through the corporation or for the benefit of the corporation and not by the stockholder in his own right. The wrong is not done to the shareholders as individuals, nor to the shareholders collectively, it is done to the corporation as an independent being, and thus indirectly the rights of those who are or who may become stockholders are affected. In buying the promoters' mine, the directors of the corporation acted for the corporation, as such, without regard to who were the then stockholders, or even if there were no stockholders. Whoever becomes an originally contemplated shareholder coming in afterwards has as much right to say that the

rights of the corporation were not protected and to insist that it should assert its remedy for the wrong done it, as one in at first but not informed. Subsequent subscriptions to original stock as a part of the scheme of promotion do not change the identity of the corporation, but remove an impediment to the enforcement of a remedy for a wrong previously done the corporation. The wrong is not done when the innocent public subscribes, but when the sale was made to the corporation at a grossly exaggerated price with secret profit. The occasion for complaining of this wrong comes when the promoters issue to the public the balance of the stock in order to provide the money necessary to set the corporation on its feet and to give thereby the contemplated value to the stock taken by themselves in payment for their mines. The exemption of the promoter from liability to the corporation for a sale without disclosure when he takes the entire issue of capital stock is an exception to the general rule imposing upon him the liabilities of a trustee. If this exception is to be extended to a case like the present, it leaves nothing of substantial value in the original rule. It might still reach small and grosser forms of want of fidelity to corporations, but would leave unharmed the vastly greater and more refined variety illustrated by the present case. It would point the way to general immunity for the wary.

It is also urged that the maintenance of this suit works an injustice to the defendant in requiring a repayment to the corporation, which will result in a benefit to the thirteen fifteenths of the capital stock taken by the defendant and Lewisohn (who condoned the wrong) as well as to the two fifteenths subscribed for by the innocent public. The size of the repayment which may be required of the defendant is due to the enormous profit taken at the outset. Apart from the unjust profit taken by the promoters, their interest in the plaintiff was only eight seventeenths, or, tested by the cost and intrinsic value of the property conveyed, four seventeenths. The true answer, however, is given by JESSEL, M.R., in *New Sombrero Phosphate Co.* v. *Erlanger*, 5 Ch.D. 73, at p. 114: "It is said that is not doing justice, and that the suit cannot be maintained in this form, because it will not do justice. But that argument goes too far, because it would apply to a case of the grossest fraud in every instance in which one or more of the actual shareholders of a company took part in that fraud. If the argument were once allowed to prevail, it would only be necessary to corrupt one single shareholder in order to prevent a company from ever setting the contract aside. It may be said you give to the shareholder, who was a party to the fraud, a profit, because he will take it in respect of his shares, and since as between co-conspirators there is no contribution, therefore his brother conspirators, who are made liable for the fraud, cannot make him repay his proportion. But the doctrine of this court has never been to hold its hand and avoid doing justice in favor of the in-

nocent, because it cannot apportion the punishment fully amongst the guilty. A dozen parties to a fraud may be defendants, and one decree or judgment go against all, and if it is a fraud of such a character that none of them can bring an action for contribution, the plaintiff may at his will and pleasure enforce that judgment against any one of them, and perhaps pass over the most guilty of them; still there is no remedy as between those who commit the fraud. It is one of the punishments of fraud that there is no such remedy, and that a guilty party, though not the most guilty, may suffer the greatest amount of punishment. It is one of the deterrents to men to prevent their committing fraud." See also *Stockton* v. *Anderson*, 13 Stew. (N.J.) 486.

It is said further that the result reached is harsh from the business man's point of view. A discussion of this aspect of the case involves ethical considerations. Courts are constantly dealing with the various relations of the business world. Legal principles are applied to these transactions, but such principles "have almost always been the fundamental ethical rules of right and wrong." *Robinson* v. *Mollett*, L.R. 7 H.L. 802, 817. Upon its distinctly moral side, there is little to the credit of the defendant and his associate. The offering by the defendant as promoter for public subscription for cash at par a substantial part of the capital stock of a corporation, the rest of whose capital stock had been issued for property conveyed to it under a law which permitted such stock to be issued only for the real value of property, was equivalent to a representation that no fictitious value had been placed upon the property so acquired. But the distinct finding of the single justice is that the real value was less than one third the price for which the defendant and Lewisohn sold it. Nothing can be said in support of a business enterprise carried on by promoters, which involves the purchase by them of mines, costing and intrinsically worth $1,000,000, with money in substantial part solicited from associates on representations that a corporation is to be formed with a capitalization of $2,500,000, of whose stock $2,000,000 is to be issued for the conveyance to it by them of the mines, and the rest for cash; the actual organization of the corporation under the laws of a State which permitted the issuance of capital stock for property conveyed only to the real value of the property, with a capital stock of $3,750,000, of which $3,250,000 is issued as fully paid for the conveyance of the mines; the settlement with a very great majority of the associates on the basis of a sale for $2,000,000 of stock as at first represented, the promoters retaining $1,250,000 of shares as a secret profit, intending also to procure from the public subscriptions for $500,000 of stock in cash at par and actually carrying out this purpose, the promoters themselves during all these manipulations having entire control of all executive offices of the corporation. In the absence of compelling authority, we cannot set

the seal of judicial approval upon such business policies. See *Bigelow* v. *Old Dominion Copper Mining & Smelting Co.*, 4 Buch. (N.J.), 71 Atl. Rep. at pp. 176 and 177.

Both on authority outside of our own cases and on principle, it appears to us that the defendant should be held liable. But in this jurisdiction the matter does not stand quite on the basis of an original proposition. In two thoroughly considered opinions in recent years, *Hayward* v. *Leeson*, 176 Mass. 310, and *Old Dominion Copper Mining & Smelting Co.* v. *Bigelow*, 188 Mass. 315, this court has held that liability existed in a case like this. It is not necessary to repeat the arguments of these decisions. There is thus added to considerations which otherwise exist, the force of the doctrine of *stare decisis*. One or both of these cases have frequently been cited by courts of other jurisdictions and always with approval until *Old Dominion Copper Mining & Smelting Co.* v. *Lewisohn*, 148 Fed. Rep. 1020; s.c. 210 U.S. 206. No arguments have been adduced not considered in those cases, and no points now brought forward were not there discussed. While the rule of *stare decisis* does not prevent the overruling of those cases, they should not be disturbed unless they now appear to be so clearly wrong as to have no sound support. *Mabardy* v. *McHugh*, 202 Mass. 148. It must appear that the law was "misunderstood or misapplied." 1 Kent Com. 475. There was no misconception of the points involved when these cases were decided, nor any lack of discernment in their application to the affairs of corporations. It does not appear that they have become archaic or inapplicable by reason of business evolution since they were announced. On the contrary, the tendency of custom since the first case was decided has been rather in the direction of more strict accountability of those owing duties to corporations and their stockholders. At all events, we perceive no occasion to relax these principles of accountability for breaches of trust. The mere fact that the Supreme Court of the United States has since decided the question differently is not alone a sufficient consideration for reversing our decisions. It is only when the reasoning of its decision is of convincing power and compels the conclusion that our cases were wrongly decided that it must command our support in other branches of the law than those where it is supreme under the Federal Constitution. With great respect to the decision in 210 U.S. 206, we are constrained to adhere to the law as laid down in the earlier cases in this Commonwealth.

We have discussed the question as if the same legal principles are involved now as were presented upon the demurrer. There are, however, certain aspects of the evidence which seem to us to make it essentially different and materially stronger for the plaintiff. When the votes to purchase the mines of the promoters were passed on July 11, only forty shares of stock had been subscribed for or issued.

The votes were passed by the directors alone and there was no vote by the stockholders at this time. It is true that the directors comprised all the stockholders, but on that date they were acting wholly in their capacity as directors, that is, as trustees. They did not attempt, so far as any records show, to shift their character as trustees for that of individual stockholders. They did not pursue the careful course of separation of these dual capacities by calling a stockholders' meeting, which was followed in *North-West Transportation Co.* v. *Beatty*, 12 App. Cas. 589, nor did they assent in writing as stockholders. So far as the records show up to this point, there was only a directors' vote for the purchase. Moreover, the records of the plaintiff show that at the opening of this meeting only six of the seven directors were present. Four of these six directors resigned as did also the absent seventh director, their resignations were accepted and their successors were chosen. But of the five newly chosen directors, only two were present and took their seats. Thus there were four directors, a bare quorum and majority, present when the offers for the sale of the mines were presented and the votes for their purchase were passed. These votes to purchase were not consummated until December, 1895, and January, 1896, when the deeds were delivered to the plaintiff. The vote to issue the certificates of stock in payment for the conveyances of mines was passed on September 18, 1895. Under date of July 18, 1895, the only subscription list of the plaintiff was signed. Upon this list appear the names of those outside persons who subscribed for the $500,000 of working capital for the plaintiff. The money was paid by some of the outside stockholders before September 18, and at least as early as September 10, 1895. Stock certificates were made out for the number of shares allotted to each under date of September 18. The rights of all these persons as subscribers had become fixed at least as early as September 10, 1895, before which date the subscriptions were all received, and when notices of their acceptance and demands for payment were sent out. These circumstances amply support the finding of the single justice that issuance of the twenty thousand shares to the public was in the summer or fall of 1895. These stockholders were entitled to have a disclosure made to the corporation through independent officers. There is no pretense that any disclosure was made to these subscribers. On September 18, 1895, the directors of the plaintiff voted to issue the stock as before stated — thirty thousand shares to Bigelow and Lewisohn, one hundred thousand to their nominee Dumaresq, and there was made out the certificate for the remaining twenty thousand shares to "Thomas Nelson, Treasurer," and these four, professing to represent all the stock of the plaintiff, signed the written approval of all previous acts of the directors. This is the first attempt of the stockholders to act respecting this subject. As before pointed out, the certificate to Nelson was wrongfully issued;

except as it belonged to outside subscribers, it was treasury stock. There were then other stockholders of the plaintiff who had paid for their stock, although they had not received their certificates, but the plaintiff had their money and they were entitled to be treated as stockholders. *Chester Glass Co.* v. *Dewey*, 16 Mass. 94. *Chaffin* v. *Cummings*, 37 Maine, 76. *Hawes* v. *Anglo-Saxon Petroleum Co.*, 101 Mass. 385, 395. Their certificates were dated September 18, 1895, and issued directly. These circumstances show that at the first and only time when there was an effort on the part of the promoters to secure a ratification of their wrongful acts, there were certain shareholders who were not represented and who did not themselves sign in assent and who were in fact ignorant of the wrong done the corporation. Further, they do not show that at any time from the organization of the corporation onward was there a moment when all the stockholders or directors knew of the material facts as to the defendant's relation to the corporation. In this view of the facts, which is supported fully by the evidence, there appears to be no assent by the corporation with knowledge of the facts by all those who at any time constituted all the stockholders, except by assuming the knowledge of Bigelow and Lewisohn on July 11, 1895, when there were only forty shares of stock for which the latter had paid, to be the knowledge of all the stockholders, although there were then seven shareholders as to whose actual knowledge of the scheme there is no evidence, although all were the tools of the defendant and Lewisohn. It is only by treating these subscriptions as a sham that knowledge even of the owners of the forty shares can be found. But these subscriptions were necessary to the organization under the New Jersey law. Hence the rule of *Salomon* v. *Salomon* [1897], A.C. 22, and like cases has no application to these facts, nor does the difficulty meet "the petitioner at the outset that it has assented to the transaction with the full knowledge of the facts" (210 U.S. 211, 212), unless it is said that in fact knowledge by the plaintiff's dominant stockholders is knowledge by the corporation. But the defendant was committing a breach of trust on his principal, the plaintiff, and where one is committing a wrong in his own interest his knowledge does not bind the corporation, which might in an innocent transaction be affected by his knowledge. *Indian Head National Bank* v. *Clark*, 166 Mass. 27. *Produce Exchange Trust Co.* v. *Bieberbach*, 176 Mass. 577, 588. These considerations mark the case as different in material respects from that which was stated in *Old Dominion Copper Mining & Smelting Co.* v. *Lewisohn*, 210 U.S. 206, and bring it clearly within the well recognized rule of promoters' liability, laid down in the numerous and undisputed cases, before cited. The Supreme Court of the United States has never passed upon these facts nor upon such a case as is thus presented. We know of no authority which countenances a different decision upon them than that here reached. The

conflict between the federal courts and this court in this respect appears to be not upon the merits of the case as disclosed upon the present record. See *Bigelow* v. *Old Dominion Copper Mining & Smelting Co.*, 4 Buch. (N.J.), 71 Atl. Rep. 153, 175.

But there is still another aspect in which the case differs from that presented in the federal court and in our previous decision. The defendant held out to subscribers of his syndicate, before the incorporation of the plaintiff, that its capital stock was to be $2,500,000 and that they would get for one share in the Baltimore Company two in the new company and that the rest would be sold to furnish the working capital. The right of these parties to become stockholders in the plaintiff company was fixed before its first meeting of stockholders was held, because they had signed the syndicate agreement and had made two payments on account of their subscriptions. They were sharers thus in the profit of $1,000,000 above the costs of mines. But they were also entitled to disclosure of the secret profit of $1,250,000 more taken by the defendant and Lewisohn and it is found that most of them were ignorant of it. Respecting any sale to the plaintiff in which they had agreed to become shareowners on any other basis than that of two for one, they were entitled to disclosure. This is quite aside from any rights they may have had against Bigelow for not treating them fairly on the division of profits. It stands on different ground. In that relation they were sharers in promoters' profits and they received what they expected. But they had also agreed to be subscribers to stock of the plaintiff. In that character they were not promoters, but stockholders and entitled to all their rights. That they knew there was to be a sale for $2,000,000 and a profit of two for one was no reasonable ground for expectation that the defendant would take a large additional secret profit. As to this secret profit, the members of the syndicate had the same rights as the outside public, that is, they were entitled to a disclosure to an independent and impartial board of officers who should be in a position to act for the interests of the corporation as opposed to those of the promoters. In this regard the case is like *Arnold* v. *Searing*, 3 Buch. (N.J.) 262, where the defendants were held liable. . . .

It follows from what has been said as to the nature of the wrong done by the defendant that he is liable *in solido*. The act of the defendant and Lewisohn was a joint act for the benefit of both. Their subdivision of the profits made cannot affect the right of the plaintiff. The breach of trust, which they as promoters committed, was in the nature of a tort. This renders them liable severally as well as jointly and for the whole damage. *Hayward* v. *Leeson*, 176 Mass. 310, 324, and cases cited 188 Mass. at p. 329. *Feneff* v. *Boston & Maine Railroad*, 196 Mass. 575, 581. *Gluckstein* v. *Barnes* [1900], A.C. 240. *Bigelow* v. *Old Dominion Copper Mining & Smelting Co.*, 4 Buch. (N.J.), 71 Atl. Rep. 153, 176.

As to the character of relief which can be afforded, it is said first that rescission is the only remedy open to the petitioner. The single justice has found that the situation of the parties and the properties is not such as to make it just at this time to order a rescission. The evidence justifies this finding. It was decided in this case at its earlier stage, 188 Mass. 315, 329, that rescission is not the only remedy. *Hayward* v. *Leeson*, 176 Mass. 310, 321. *Parker* v. *Nickerson*, 137 Mass. 487. We are not disposed to question the correctness of the decision upon this point. When one has committed a breach of trust, there is no occasion to be over-solicitous to see that the faithless fiduciary should not make reparation for the wrong done. *In re Olympia* [1898], 2 Ch. 153, 169. *Lyndney & Wigpool Iron Ore Co.* v. *Bird*, 33 Ch.D. 85, 94. The essence of the suit is that a secret profit was taken by the promoters. The obvious remedy is a return of the secret profit. The difficulty of ascertaining the amount of that profit, which troubled the court in *In re Cape Breton Co.*, 29 Ch.D. 795, does not exist here. See *Bentinck* v. *Fenn*, 12 App. Cas. 652; *Gluckstein* v. *Barnes* [1900], A.C. 240; *In re Leeds & Hanley Theatres of Varieties* [1902], 2 Ch. 809; *Yale Gas Stove Co.* v. *Wilcox*, 64 Conn. 101.

The plaintiff has also appealed from the decrees in its favor. It presses its appeals on the ground that it is entitled to recover the difference between the market value of the shares received by the defendant and Lewisohn and the cost to them of the property conveyed to it. This is the measure of recovery where there is a fiduciary relation at the time of the purchase. But there is no finding here that such relation existed at the time the defendant and Lewisohn purchased the property. There is no evidence which requires such a finding. The corporation was not organized until a considerable period after the options had been secured. The defendant and Lewisohn were, during all this time, free to do as they chose with their purchase so far as the plaintiff was concerned. This has been before decided, 188 Mass. 321. The plaintiff contends in the alternative that its measure of damage is the difference between the intrinsic value of the property conveyed and the value of the stock issued therefor. Market value is the standard commonly applied where property has such value. It is only in cases where the value of property cannot be fairly ascertained by the application of this test that resort is had to any other. The single justice appears to have experienced no difficulty in determining that value of these mines. There are no exceptional circumstances which call for the application of any other than the ordinary rule.

NOTE. — LORING, BRALEY, and SHELDON, JJ., concurred. KNOWLTON, C.J., and MORTON and HAMMOND, JJ., dissented.

Hughes v. *Cadena Co.*, 13 Ariz. 52. A corporation, with outstanding stock, issued stock to its promoters, without consideration. One of the existing stockholders knew nothing about the transaction. The court ordered these shares cancelled. There is a *dictum* that, if all the existing shareholders had consented, the corporation could not have been heard to complain, even if after the transaction other stock was sold to the public. There is also a *dictum* that the issue by a corporation, having no assets, of its shares of stock without consideration constitutes the obtaining of a profit by the promoters.

Burbank v. *Dennis*, 101 Cal. 90. If promoters represent that they are conveying property to the corporation at cost, and cash is paid to them in excess of their expenditures, the corporation is entitled to recover the difference.

Yale Gas Stove Co. v. *Wilcox*, 64 Conn. 101. A promoter had procured subscriptions to the stock of a corporation organized to buy certain patents owned by A. These patents were paid for, partly in stock, and partly in cash. A then gave part of the consideration to the promoter. The subscribers had no knowledge that the promoter was making this profit. He was required to account.

Hinkley v. *Oil Co.*, 132 Iowa, 396. The promoters of a corporation caused stock to be issued to them for a contract right. The facts were such that the court treated this as substantially an issue of stock without consideration. Part of the stock so issued was returned to the treasury and sold to the public. A purchaser brought an action for the amount paid for the stock, and to cancel said stock. The defendants were the corporation and one of the promoters. Relief was given as prayed.

Higgins v. *Lansingh*, 154 Ill. 301, 332, 337. By the issue of the stock to a promoter for overvalued property the company is not defrauded, where it has no assets except the property so received. Holders of preferred stock, issued at a subsequent date, were not, on the facts, entitled to complain.

Camden Land Co. v. *Lewis*, 101 Me. 78. There is a *dictum* (p. 95) that promoters of a corporation stand in a fiduciary relation to the corporation, and to its subscribers for stock, and to those who it is expected will afterward buy stock from the corporation; that if they undertake to sell their own property to the corporation they are bound to disclose the whole truth; and that if they receive secret profits, either in cash or by way of allotments of stock, when there are other stockholders, or it is expected that there will be other holders of new and additional stock, the corporation may elect to avoid the purchase, or hold the promoters accountable for the secret profits, if in cash, or may require a return of the stock if unsold; "or, if sold, an accounting for the profits of its sale."

Mason v. *Carrothers*, 105 Me. 392. The owners of certain patents contracted with promoters of a corporation to be formed to transfer

the patents to the corporation for a specified consideration, including $100,000 par value of the preferred stock and $50,000 of the common stock. The promoters caused the corporation to be formed. Six shares of stock were subscribed by persons dominated by the promoters. The directors also were dominated by the promoters. The promoters thereupon, assuming to be owners of the patents, sold them to the corporation for the consideration mentioned in the contract with the owners of the patents, except that they received $799,400 of common stock. They gave $50,000 of the common stock to the owners of the patents, donated $200,000 to the corporation, and retained $549,400. Subsequently persons who subscribed and paid for preferred stock (the authorized issue was $200,000 and only $100,000 had been issued to the promoters) without knowledge of the contract between the promoters and the owners of the patents brought a bill praying that the $549,400 stock should be cancelled. This relief was granted (except as promoters were found to be entitled to stock for their services and expenses). The court held that the relief could not be granted on the ground that there was no consideration for the issue of the stock, and it approved a finding that the promoters were the equitable, if not the legal, owners of the patents when they assumed to transfer them to the corporation. But the court held that the relief could be granted on the ground that the promoters had made a secret profit. "Here the parties selling are the promoters, and the parties buying are not the existing dummy stockholders but the future real stockholders whose cash alone will go into the treasury of the corporation and enable it to begin and carry on business" (p. 399). The court said its decision was not inconsistent with *Old Dominion Copper Co.* v. *Lewisohn*, 210 U.S. 206, because the preferred stockholders, and not the corporation, were suing; but it then proceeded to hold that it was proper for the plaintiffs to bring the suit, because the guilty parties were in control of the corporation. It is to be noted that the court did not proceed on the ground that the patents had been overvalued and that a profit had thereby been made at the expense of the corporation.

Tompkins v. *Sperry, Jones & Co.*, 96 Md. 560. Promoters purchased various breweries, the purchase price to be paid largely in securities of a corporation to be formed. They conveyed these properties, with a certain amount of working capital, to a corporation, formed and controlled by them, in consideration of the issue to them of its stock and bonds. The promoters then made sales of the securities so issued, but the public was not invited by the corporation to subscribe to its stock. It was held that, even if the promoters secured a greater amount of securities for themselves than was contemplated in their contracts with the owners of the various breweries, this gave the corporation no cause of action. "Assuming that these contracts called for the delivery by them to the respective brewers of

bonds and stock of the company capitalized upon a certain basis and that they delivered securities issued upon a different basis of capitalization, that might afford to each individual brewer a right of action against Sperry & Jones for such damage as he suffered under the terms of his particular contract, but these *various contract rights* of the different brewers cannot be asserted collectively in this suit by the receiver" (p. 583). And see *Granite Roofing Co.* v. *Michael*, 54 Md. 65.

United Zinc Companies v. *Harwood*, 216 Mass. 474. The right of a corporation to maintain a suit in equity against promoters to recover secret profits is not assignable at law or in equity.

South Joplin Land Co. v. *Case*, 104 Mo. 572. A promoter caused a corporation to be formed and its stock was subscribed by members of the public. The cash of the corporation was then used in payment of property on which the promoters had an option. But the vendor returned to him $2000 of the purchase price and gave him certain assets which he did not transfer to the corporation. The promoter concealed these facts. He was required to disgorge.

Arnold v. *Searing*, 78 N.J. Eq. 146. Where promoters buy property and transfer it to a corporation formed and controlled by them in consideration of the issue to them of all its stock and bonds then authorized, they owe a duty of full disclosure to the members of the syndicate who provided the funds necessary to carry through the transaction, and who were to receive stock and bonds in consideration of their cash payments, such persons being equitable stockholders. Such disclosure not having been made, the promoters are jointly and severally liable, in a suit by the corporation, to account for the profits made. In determining these profits the value of the securities obtained must be determined, and bonus stock must be treated as having no value, if all persons interested in the transaction so treated it.

Tooker v. *National Sugar Refining Co.*, 80 N.J. Eq. 305. The stockholders of three sugar refining companies, which were engaged in destructive competition with the American Sugar Refining Co., of which Havemeyer was president, transferred their stock to a new corporation formed and controlled by an agent of Havemeyer, and took in payment shares of its preferred stock. The common stock was issued to a trustee for Havemeyer. The court held that this stock was issued without consideration, and that the holders were not entitled to vote or receive dividends thereon. The court gave the holders the right to retire such stock in any legal manner.

Parsons v. *Hayes*, 14 Abb. N.C. (N.Y.) 419. All the stock of a corporation is issued for overvalued property. A transferee, without notice of this fact, of some of the stock cannot complain. His transferor participated, and therefore could not complain, and he stands no better.

Blum v. *Whitney*, 185 N.Y. 232. The Distilling Company of America was formed to acquire certain properties, chiefly by issues of its stock. The persons who took the initiative in its organization held an option on one of these properties, and (apparently) this property was conveyed to the corporation at a price higher than the price named in such option. The complaint alleged that they did not disclose to the owners of the other properties that they held such option, and that they did not state the amount which the corporation was to pay therefor. Some of the stock of the Distilling Company was to be left in its treasury " for future purposes." The report of the case does not show that any of this stock was subsequently issued, and it does not appear how the plaintiff acquired his stock in the Distilling Company. The court dealt with the case as though all the stock of the corporation had been issued for the properties in question. The court was apparently of opinion that if any fraud had been practised by the defendant upon any of the persons who took the original issue of stock, that would not give rise to a corporate right (pp. 241, 242). It cites with approval *Tompkins* v. *Sperry, Jones & Co.*, 96 Md. 560.

See also *Hutchinson* v. *Simpson*, 92 N.Y. App. Div. 382; *Insurance Press* v. *Montauk Wire Co.*, 103 N.Y. App. Div. 472 (if promoters receive stock for overvalued property, the corporation cannot retain the property, and cancel all the stock except that equal to the real value of the property).

Wills v. *Nehalem Coal Co.*, 52 Or. 70. Part of the stock of a corporation is issued to promoters for overvalued property. Then other stock was issued to the plaintiffs for cash at par. A demurrer to the complaint was overruled. Relief will be either to require the payment of the par value of the stock, less the value of the property, or the cancellation of the stocks "according as one or the other may seem to the court to be more equitable when the facts are before it" (p. 91).

Densmore Oil Co. v. *Densmore*, 64 Pa. 43. Owners of property employed promoters to procure subscriptions to the stock of a corporation formed to purchase such property, and paid them out of the proceeds. The court said the owners could set any price they pleased on their property, without disclosing its cost, and that the promoters could retain whatever they were paid by the owners. The subscribers "supposed, as they state, that these gentlemen were to receive compensation for their services. What it was to be they did not inquire, because it was none of their business."

Richlands Oil Co. v. *Morriss*, 108 Va. 288. The promoters of a corporation issued a majority of its stock to themselves for rights of exploration. These rights cost $52 and stock of the par value of $600,000 was issued in payment. Then other stock was sold to the public. The stock in the hands of a promoter was cancelled.

Richardson v. *Graham*, 45 W.Va. 134. A promoter, having an

option on property for $6000, sold the property to the corporation for $8500, without disclosing the profit. The court said: "It could not concern the company or any of its stockholders what the property originally cost Graham" [the promoter] (p. 140). But the court also said: "The only fraud claimed . . . was in concealing the price paid for the property by Graham: but it is apparent on the face of the record that after the facts were made known, and the company chartered and organized, it contracted to purchase the property for eight thousand five hundred dollars" (p. 142).

Pietsch v. *Milbrath*, 123 Wis. 647. The facts are obscure. Apparently, the promoters represented that they had subscribed for 1472 shares at $34 a share; the general public was induced to subscribe to 562 shares at $34 a share; the promoters conveyed property to the corporation, which they had acquired by paying some cash, and giving purchase money mortgages; they reimbursed themselves for the cash out of the amounts paid by the general public, and therefore obtained the 1472 shares without any consideration. The defendants were required to pay $50,048 (1472 × $34), with interest, the court holding that the corporation had been defrauded out of that amount.

See also *Dickerman* v. *Northern Trust Co.*, 176 U.S. 181, 203; *Foster* v. *Seymour*, 23 Fed. 65; *Stratton's Independence, Ltd.* v. *Dines*, 135 Fed. 449.

BOOK III.

THE POWERS OF CORPORATIONS.

NOTE.

The stockholders of a business corporation may be said to be persons who would be partners, except for their incorporation, and who are, by their incorporation, enabled to carry on business with certain facilities and with a protection against liability not enjoyed by partners.

When the powers, or objects, or purposes of a corporation are stated in its organization papers, the statement has a double significance. On the one hand, it evidences the compact between the members, and, in this respect, is closely analogous to articles of partnership. On the other hand, it marks the limits within which the State consents that the members may engage in business with the corporate facilities and protection.

Many acts done in the name of the corporation prove to be unauthorized both as against the State, and as between the members.

An act, however, may be unauthorized as against the State, although not as between the members. Thus, if all the members agreed that an act should be done which the State had not authorized.

An act, moreover, may be unauthorized as between the members, although it is no usurpation as against the State. Suppose it is provided that no money is to be borrowed, and no mortgage placed on the corporate property without the consent of the holders of, say, two thirds of the capital stock. It is submitted that the proper construction of such a provision ought usually to be that it was designed solely as a protection to the stockholders.

The expression "*ultra vires*" is frequently used in the reports to indicate a transaction which is beyond the scope of corporate activity authorized by the State. But it is also quite frequently used to indicate a transaction which is not authorized by the compact of the members *inter se*.

The question as to the proper use of this expression is merely a question as to the desirable use of language. For the sake of clearness, this work will be constructed on the conception that no transaction is *ultra vires*, unless such transaction is beyond the scope of corporate activity authorized by the State.

The cases given in Chapter I, *infra*, are designed to show what

transactions are *intra vires,* as contrasted with *ultra vires,* used in the sense stated in the preceding paragraph. That is to say, what transactions are within the scope of corporate activity authorized by the State.

Acts which violate the compact between the members will be considered in the chapter on Stockholders.

Acts which are *ultra vires* will be considered in the book on Unauthorized Corporate Action.

CHAPTER I.

EXTENT OF THE POWERS.

SECTION 1.

IN GENERAL.

DOWNING v. MOUNT WASHINGTON ROAD COMPANY.

40 N.H. 230. 1860.

Assumpsit to recover the price of certain articles, among them eight omnibuses and a baggage wagon. The omnibuses and baggage wagon were intended to be used in conveying passengers up and down the mountain, after the road was completed. The omnibuses were constructed in a peculiar way, and were not fit for use on ordinary roads.

By their act of incorporation, passed July 1, 1853, the corporation was empowered to lay out, make and keep in repair, a road from such point in the vicinity of Mount Washington as they may deem most favorable, to the top of said mountain, etc., and thence to some point on the northwesterly side of said mountain, etc., to take tolls of passengers and for carriages, to build and own toll-houses, and to take land for their road.

It appeared that by an additional act, passed July 12, 1856, the corporation were authorized "to erect and maintain, lease and dispose of any building or buildings, which may be found convenient for the accommodation of their business, and of the horses and carriages and travelers passing over said road."

One question presented was whether the purchase of such omnibuses and baggage wagon was within the power of the corporation.

Bell, C.J. Corporations are creatures of the legislature, having no other powers than such as are given to them by their charters, or such as are incidental, or necessary to carry into effect the purposes for which they were established. *Trustees* v. *Peaslee*, 15 N.H. 330; *Perrine* v. *Chesapeake Canal Co.*, 9 How. 172. In giving a construction to the powers of a corporation, the language of the charter should in general neither be construed strictly nor liberally, but according to the fair and natural import of it, with reference to the purposes

and objects of the corporation. *Enfield Bridge* v. *Hartford R.R.*, 17 Conn. 454; *Strauss* v. *Eagle Co.*, 5 Ohio (N.S.) 39.

If the powers conferred are against common right, and trench in any way upon the privileges of other citizens, they are, in cases of doubt, to be construed strictly,[1] but not so as to impair or defeat the objects of the incorporation.[2]

In the present case the power to take the lands of others, and to take tolls of travelers, must be strictly construed, if doubts should arise on those points; but it is not seen that the other grants to the defendant corporation should not receive a fair and natural construction.

The charter of the Mount Washington road empowers them to lay out, make and keep in repair, a road from Peabody River Valley to the top of Mount Washington, and thence to some point on the northwest side of the mountain. It grants tolls on passengers and carriages, and authorizes them to take lands of others for their road, and to build and own toll-houses, and erect gates, and appoint toll-gatherers to collect their tolls. The remaining provisions contain the ordinary powers of corporations, relating to directors, stock, dividends, meetings, etc. Laws of 1853, chapter 1486.

This charter confers the usual powers heretofore granted to turnpike corporations, and no others. The most natural and satisfactory mode of ascertaining what are the powers incidentally granted to such companies, is to inquire what powers have been usually exercised under them, without question by the public or by the corporators. It may be safely assumed that the powers which have not heretofore been found necessary, and have not been claimed or exercised under such charters, are not to be considered generally as incidentally granted. Such charters have in former years been very common in this and other States, and they have not, so far as we are aware, been understood as authorizing the corporations to erect hotels, or to establish stage or transportation lines, to purchase horses or carriages, or to employ drivers in transporting passengers or freight over their roads; and no such powers have any where been claimed or exercised under them. We are, therefore, of opinion that the power to establish stage and transportation lines to and from the mountain, to purchase carriages and horses for the purpose of carrying on such a business, was not incidentally granted to the defendant corporation by their charter. *State* v. *Commissioners*, 3 Zab. 510.

But it is contended that the power to make this contract is conferred by the act in amendment of the charter, passed July 12, 1856. By this act the corporation may "erect and maintain, lease and dispose of any building or buildings which may be found convenient for the accommodation of their business, and of the horses and car-

[1] See *Stourbridge Canal* v. *Wheeley*, 2 Barn. & Ad. 792.
[2] See *Whitaker* v. *Delaware Canal Co.*, 87 Pa. 34.

riages and travelers passing over their said road." By *their business*, which the buildings to be erected were designed to accommodate, it is said the legislature must have intended some permanent and continuing business beyond that of merely building and maintaining a road; and that it could be no other than that of erecting a hotel on the mountain, and establishing lines of carriages, for the purpose of carrying visitors up and down the mountain.

But the foundation of this implication is very slight. The express grant is of an authority to erect, etc., buildings, not of all kinds, but such as may be found convenient for the accommodation of their business, and of travelers, etc. The business here referred to must be understood to be such as they are by their charter authorized to engage in. If nothing had been said of horses and travelers, there could hardly be any foundation for the idea that a hotel could have been contemplated by the legislature. Buildings suitable for the accommodation of their toll-gatherers and workmen employed on their road, would probably be thought every thing the legislature intended to authorize by this additional act. Connected as this authority now is with travelers, horses and carriages, there is scarce a pretence for argument, that this additional act goes any further than the original act, to authorize a stage and transportation company. It is not unlikely that some of the projectors of this enterprise intended to secure much more extensive rights than those of a turnpike and hotel company, but it seems certain they have not exhibited this feature of their case to the legislature so distinctly as to secure their sanction, and the charter and its amendment as yet justifies them in no such claim.

[The court held that the defendant was not liable on the contract for the omnibuses and baggage wagon.]

NOTE. — See, *accord*, *Chewacha Lime Works* v. *Dismukes*, 87 Ala. 344 (a corporation whose objects are to mine lime rock and manufacture the same has no implied or incidental power to carry on a general mercantile business); *Cherokee Iron Co.* v. *Jones*, 52 Ga. 276 (a corporation organized to manufacture pig iron has no power to erect a corn and flour mill); *Bangor Boom Corporation* v. *Whiting*, 29 Me. 123 (a corporation with power to boom lumber has no power to drive lumber).

PEOPLE *ex rel.* TIFFANY & CO. *v.* CAMPBELL.

144 N.Y. 166. 1894.

ONE question was whether the capital of Tiffany & Co. employed in the purchase and sale of goods not manufactured by it was subject to taxation, or whether it was exempted from taxation under a statute exempting manufacturing corporations from taxation.

Andrews, Ch.J. This appeal is from an order of the General Term dismissing a writ of certiorari to review a decision of the state comptroller subjecting to taxation a portion of the relator's capital employed in this state in the years 1889, 1890 and 1891.

The relator is a manufacturing corporation in this state, organized under the general law for the incorporation of manufacturing companies, for the manufacture and sale of gold and silverware and other articles of ornament and use. Its capital, stated in the certificate, is $2,400,000, which by accretion now exceeds $3,000,000. It has a store for the sale of its products in the city of New York. It employs from six to eight hundred men in its manufacturing business in this state and about eighty per cent of its capital. All of this capital, except a portion varying in different years from twelve to fifteen per cent, is invested in its manufacturing business. The portion not employed in that way, amounting on the average to about $300,000 a year, is employed in the purchase and sale of goods, principally of foreign manufacture, of the same general character as the goods manufactured by the relator, but of a cheaper description, which it cannot itself advantageously manufacture, but which are necessary in order to make its stock complete, and to meet the wants of customers.

It is claimed that the purchase and sale of goods not manufactured by the relator, merely to complete its stock, and limited to articles which it could not advantageously manufacture itself, was incidental and subsidiary to the exercise of its corporate power as a manufacturing company, and, therefore, within the power granted. It is well settled that a corporation possesses not only powers specifically granted in terms, but (as expressed in the Revised Statutes) such powers "as shall be necessary to the exercise of the powers so enumerated and given." (1 Rev. St. 600, § 3.) The unexpressed and incidental powers possessed by a corporation are not limited to such as are absolutely or indispensably necessary to enable it to exercise the powers specifically granted. Whatever incidental powers are reasonably necessary to enable it to perform its corporate functions are implied from the powers affirmatively granted. (Comstock, J., *Curtis* v. *Leavitt*, 15 N.Y. 64.) But powers merely convenient or useful are not implied if they are not essential, having in view the nature and object of the incorporation. The power assumed by the relator in this case to supply from other sources goods which it could not itself profitably manufacture, was a convenient and useful one, and doubtless contributed to the success of its general business, but it cannot, we think, be said to be essential to its business as a manufacturing corporation. The power to sell its products, even if it had not as in this case been expressly included among the enumerated powers, would be necessarily implied in the charter of a manufacturing corporation. Without the power of sale the business of production could

not be carried on. The power to sell is an indispensable adjunct to a manufacturing business. But the same considerations do not apply where a manufacturing corporation is also engaged in the purchase and sale of goods manufactured by other parties. This part of the relator's business was not, we think, within its chartered powers.

[The court held that a tax was payable on the capital so employed.]

NOTE. — See also *Nicollet Bank* v. *Frisk-Turner Co.*, 71 Minn. 413.

U. S. BREWING CO. *v.* DOLESE.

259 Ill. 274. 1913.

MR. JUSTICE FARMER delivered the opinion of the court:

Plaintiff in error (hereafter called plaintiff) brought this action of assumpsit in the municipal court of the city of Chicago against defendant in error (hereafter referred to as defendant) for the recovery of $10,000 alleged to be due plaintiff from defendant. Plaintiff is a corporation organized under the laws of Illinois "to manufacture and sell all kinds of beer, ale and porter, to buy and sell all kinds of brewer's materials and supplies, and to carry on a general brewer's business in all its branches." Defendant is a corporation organized "to quarry stone, sand, clay, earth and gravel; to manufacture and deal in stone, brick, lime and cement, and deal also in sand, clay, earth, gravel, sewer and water pipe, stucco, lumber and building materials of all kinds, coal and ice, and to contract for, make and construct public and private improvements in which any such materials are employed, including roads and bridges." Defendant's quarries were near the village of Gary (or Hodgkins), in Lyons township, Cook county, about fifteen miles from the business district of the city of Chicago. The village is situated on the Atchison, Topeka and Santa Fé railroad and is about three-quarters of a mile from the quarries. In 1905 there were but few houses in the neighborhood where employees of defendant could live and the transportation facilities for conveying workmen to and from the quarries were inadequate and inconvenient. Defendant employed between one hundred and two hundred workmen, and in 1905 it employed an architect and caused plans to be prepared for a building it proposed to erect for a boarding house to accommodate its employees. Before any work was done by defendant on the building, negotiations were entered into by it with plaintiff for the construction of the building by plaintiff. These negotiations resulted in an agreement being reached by which plaintiff was to erect the building, part of it to be used as a saloon. On November 5, 1905, defendant leased to plain-

tiff, for a term commencing January 1, 1906, and ending December 31, 1930, a tract of land described, one hundred feet wide by two hundred feet deep, upon which plaintiff agreed to erect at its own expense and maintain for the term of the lease, unless sooner terminated under the provisions thereof, "a certain building, and to use and operate the same continuously for the entire term aforesaid, as a saloon and boarding house, said building to cost the sum of $6700." Plans and drawings for the building were made part of the agreement. Plaintiff erected an L-building twenty-four feet wide by one hundred and seventy-seven feet long, and an addition twenty feet by thirty feet. The portion of the building devoted to use for boarding-house purposes consisted of a kitchen, twenty-four feet by twenty-four feet; a dining room, twenty-four feet by eighty feet; forty-three double bed-rooms, and an apartment for the tenant. The part of the building devoted to saloon purposes was twenty-four feet by thirty feet. The lease contained provisions concerning its termination by defendant upon notice, and for the appointment of appraisers to value the building and make an award for the payment therefor by defendant if it elected to terminate the lease before its expiration, but those provisions are not here involved. The lease provided that "should the district within which the premises herein demised are located become a prohibition or local option district, so that on account thereof it shall be necessary to suspend the saloon business on said premises within three years from the date of this contract, then no such appraisement shall be made, but said first party [defendant] shall pay to the said second party [plaintiff] the cost price of the building and improvements on said premises such cost price not to exceed, however, the sum of $10,000." The lease authorized plaintiff to sublet the building, and after its completion plaintiff leased it at a monthly rental of $200, with a provision that if the lessee or his assigns purchased from plaintiff all beer sold on the premises, a deduction or rebate would be allowed of $120 on each month's rent. The building was conducted as a boarding house and saloon from the time of its completion. At the township election held April 7, 1908, the township of Lyons became prohibition or anti-saloon territory, and on April 9 plaintiff notified defendant, in writing, of that fact, demanded the payment of $10,000, and offered to surrender the building immediately upon payment. Defendant did not make the payment and appears to have ignored the demand. This suit was begun for the recovery of $10,000 on August 4, 1908. The declaration consisted of a special count on the contract and the common counts. Defendant pleaded the general issue and a special plea that the contract declared on in the special count was *ultra vires*. The cause was by agreement heard before the court without a jury. The court found the issues for the plaintiff, assessed its damages at $8490.12 and rendered judgment therefor. Defendant prosecuted an

appeal to the Appellate Court for the First District, and that court reversed the judgment of the municipal court. The Appellate Court was of opinion the contract was *ultra vires* the plaintiff corporation; that there could be no recovery upon the common counts, under the evidence, upon an implied contract, and the cause was therefore not remanded. A writ of *certiorari* was granted by this court.

The view of the municipal court, as indicated by propositions of law held and refused, was that the contract was *ultra vires* but that plaintiff was entitled to recover the reasonable value of the building under an implied contract. While plaintiff insists it is entitled to recover upon an implied contract if the written contract is *ultra vires*, it contends that said written contract was not *ultra vires*, and this appears to have been the principal theory upon which the case was tried in the municipal court. We agree with the municipal and Appellate Courts that it was beyond the power of plaintiff to make the contract and that the contract is void.

Plaintiff relies upon the rule announced in a number of cases that it is within the power of a corporation to adopt any proper and convenient means tending directly to accomplish the purposes for which it was organized, not amounting to the transaction of a separate, unauthorized business. Among other similar cases, reliance is placed upon *Heims Brewing Co.* v. *Flannery*, 137 Ill. 309, and *Kraft* v. *West Side Brewery Co.*, 219 id. 205. In the *Heims Brewing Co. case* the corporation was organized with power "to acquire, own and use all necessary property and means to prosecute and conduct the business of brewing and disposing of beer, with all such powers as shall be essential and incident to the convenient and successful operation of a brewery." It leased a building for a period of five years for saloon purposes. Before the term expired it abandoned the premises and refused to pay the rent. When suit was brought it defended on the ground that the contract was *ultra vires*. A part of the contract with the owner of the building was, that the owner would not engage in the saloon business during the period of the lease nor rent other property owned or controlled by him in the block for saloon purposes. The object of the contract and lease was to promote the business for which the brewery was organized by increasing the sale and consumption of beer manufactured by it, and it was held the contract was within the powers of the corporation and was valid and binding. In the *Kraft case* the brewery loaned Kraft money to erect a building for a saloon, living apartments for the owner, and for a hall in the upper story. The brewery was to be given a lease upon the premises and no other beer than that manufactured by it was to be sold thereon during the term of the lease. A mortgage was given the brewery to secure the payment of the loan, and when it instituted proceedings to foreclose the mortgage the defense of *ultra vires* was interposed. This court held that the loan was made

for a purpose not too remotely connected with the promotion of the business of the brewery and that it was within the implied powers of the corporation.

We do not think the above cases, and others relied upon, sustain plaintiff's contention. It is probably true that the boarding house would be of benefit to the saloon because of increased patronage at the bar, but because a corporation like plaintiff might do some things under its implied powers to promote its business, it does not follow that it may engage in any line of business or occupation not authorized by its charter powers because such business or occupation would promote the business for which the corporation was organized. It would be rather a far stretch of corporate powers to say that a corporation organized to manufacture and sell beer, ale and porter and carry on a general brewer's business in all its branches, could establish and operate boarding houses for the purpose of increasing the sale of its beer. This court said in *Fritze* v. *Equitable Building and Loan Society*, 186 Ill. 183: "By an implied power is meant one that is directly and immediately appropriate to the execution of the specific power granted, and not one that has slight or remote relation to it." In *Best Brewing Co.* v. *Klassen*, 185 Ill. 37, the court said: "Many acts can be suggested which, though beneficial to the business of a corporation, are too remote from its general purposes to be deemed reasonably within its implied powers. What is and what is not too remote must be determined according to the facts of each case. The rule has been stated to be: In exercising powers conferred by its charter, a corporation 'may adopt any proper and convenient means tending directly to their accomplishment, and not amounting to the transaction of a separate, unauthorized business.'" Here, more than three-fourths of the building and of the investment for its construction was for boarding-house purposes, which was a business plaintiff had no power, either express or implied, to engage in. If it did have such power, we cannot see where the line could be drawn against its engaging in any business in connection with its manufacture and sale of beer that would promote that object. In our view of the case no action could be sustained upon the contract.

[The portion of the opinion relating to recovery on the common counts is omitted.]

NOTE. — See also *Best Brewing Co.* v. *Klassen*, 185 Ill. 37. *Cf. Central Lumber Co.* v. *Kelter*, 201 Ill. 503.

Davis v. *Old Colony R.R. Co.*, 131 Mass. 258. The directors of two corporations, one a railroad corporation, and one organized to manufacture and sell musical instruments, undertook in the names of the corporations to pay part of the expenses of holding the World's Peace Jubilee and International Music Festival in Boston. The directors in so doing acted "with the reasonable belief that the holding of the

festival proposed would be of great pecuniary benefit to the corporation by increasing its proper business," and that their so undertaking would promote the holding of the festival. The court held that no action could be maintained on such undertaking against either corporation.

MALONE v. LANCASTER GAS LIGHT CO.

182 Pa. 309. 1897.

A STOCKHOLDER in the defendant sought to enjoin the issue by it of additional stock and bonds on two grounds. One ground was that the new debt was to be created for the purchase of certain patent appliances, not for the manufacture or distribution of gas, but for its consumption, the dealing in which appliances was not within the company's charter purposes.

MR. JUSTICE MITCHELL. The second branch of the case raises a mixed question of law and fact, namely, the authority of the Lancaster Gas Company to purchase the right to use and deal in the steam heater, radiating mantel and gas consuming appliances covered by the Backus patents. It is argued for plaintiff that the charter purpose of the Gas Company is limited by the words "manufacturing and supplying illuminating and heating gas," and that nothing can be included which is not a necessary part or appliance for manufacturing or supplying. This is too narrow and literal a construction, and overlooks the fundamental object of the corporation, the manufacture and supply of gas to customers for profit. It would be of no use to manufacture gas if there were not customers to buy, and hence the company may fairly supply not only the gas itself, but incidentally such appliances and conveniences as will induce new customers to use gas or old ones to use more. This is a legitimate mode of extending the company's business, in direct furtherance of its charter object. In considering such questions, much weight must be allowed to the judgment of the parties most interested, the officers and stockholders of the corporation itself, and while they will not be permitted, as against the commonwealth or a dissenting stockholder, to go outside of their legitimate corporate business, yet where the act questioned is of a nature to be fairly considered incidental or auxiliary to such business, it will not be unlawful, because not within the literal terms of the corporate grant.

This is the general rule even where corporate privileges are most strictly construed. "Corporations may transact, in addition to their main undertaking, all such subordinate and connected matters as are, if not essential, at least very convenient to the due prosecution of the former:" Green's Brice's Ultra Vires (2d ed.), ch. 3, § 2, p.86.

The illustration given by Mr. Brice is that railway companies may erect refreshment rooms or book stalls, and "adopt other similar measures for both providing for the comfort of their customers and adding to their own receipts." The American illustrations in the same line, which have revolutionized modern travel, will occur to everyone. In *Brown* v. *Winnisimmet Co.*, 11 Allen, 326, it was held that the contract of a ferry company to charter one of its boats for temporary use in another business was valid. Many illustrations are suggested in the opinion of BIGELOW, C.J., who said, "We know of no rule or principle by which an act creating a corporation for certain specific objects, or to carry on a particular trade or business, is to be strictly construed as prohibitory of all other dealings or transactions not coming within the exact scope of those designated. Undoubtedly the main business of a corporation is to be confined to that class of operations which properly appertain to the general purposes for which its charter was granted. But it may also enter into contracts and engage in transactions which are incidental or auxiliary to its main business, or which may become necessary, expedient or profitable in the care and management of the property which it is authorized to hold." See also *Lyndeborough Glass Co.* v. *Mass. Glass Co.*, 111 Mass. 315. And in our own case of Watts's Appeal, 78 Pa. 370, a land company's charter purpose was to sell a large tract of land, but it was authorized *inter alia* "to aid in the development of the minerals and other materials," and also "to promote the clearing and settlement of the country." The directors, among other things, built sawmills and a hotel. It was held that their acts were not *ultra vires*, GORDON, J., saying (page 392): "We know of no other material upon these lands more abundant or more obviously requiring development than the timber. Neither can we conceive of anything better calculated to develop this kind of materials than sawmills. So we regard a hotel of some kind in so large a territory of wild lands, as not only a convenience adding greatly to the settlement of the country, but a necessity."

In the present case the stockholders of the Gas Company by an almost unanimous vote, decided that the purchase of the Backus patents was to the advantage of the company's business as a manufacturer and distributor of gas, and the court below has found as a matter of fact that they were right. We cannot say as matter of law that they were wrong.

NOTE. — See also *Central Ohio Co.* v. *Capital City Co.*, 60 Ohio St. 96; *Searight* v. *Payne*, 6 Lea (Tenn.) 283.

PEOPLE *v.* PULLMAN CAR CO.

175 Ill. 125. 1898.

MR. JUSTICE BOGGS delivered the opinion of the court:

This is an information in the nature of a *quo warranto*, filed by the Attorney General in the circuit court of Cook county, in the name and on behalf of the People of the State of Illinois, against Pullman's Palace Car Company. Said company is a corporation, organized in 1867 by a special act of the legislature of Illinois, entitled "An act to incorporate Pullman's Palace Car Company." (2 Private Laws of 1867, p. 337.)

Sections 4 and 6 of this act were as follows:

"Sec. 4. The said corporation shall have power to manufacture, construct and purchase railway cars, with all convenient appendages, and supplies for persons traveling therein, and the same may sell or use, or permit to be used, in such manner and upon such terms as the said company may think fit and proper."

"Sec. 6. It may be lawful for the company hereby incorporated to purchase, acquire and hold such real estate as may be deemed necessary for the successful prosecution of their business, and may have power to sell and convey the same."

The information sets out the charter of the defendant, and then alleges certain acts which are alleged to be usurpations by the defendant of powers not conferred by its charter, and concludes with a prayer for the forfeiture of the charter of the corporation.

The allegations contained in the information of the usurpations of power on the part of the defendant are, in substance, as follows:

First — That it owns and controls a large ten-story business block, together with the ground on which it stands, worth two million dollars, in the business center of the city of Chicago; that it rents three-fourths of said block to persons, firms and corporations, and derives a large income therefrom; that this business block is located many miles from its works, or what is called the "Town of Pullman," and a small portion of it only is occupied by the company's employees; that this business block was built as an investment, and not because it had any real necessity therefor.

A corporation in our State has its existence by virtue of the enactment, general or special, of the law-making power. The appellee corporation was created by a special act of the General Assembly. The only difference between a corporation organized under a general law and one created by a special statute is, "that in the former we look to the certificate of the promoters, while in the latter we look to the special statute to ascertain the scope of the powers of the corporation." The rule for construing the instruments must necessarily be the same, viz., the powers specifically enumerated, and

such other powers as are incidental or necessary to carry those powers into effect, but none others may be exercised by the corporation. *Rockhold* v. *Canton Masonic Benevolent Society*, 129 Ill. 440.

The enactment creating the appellee corporation is the full measure of its power. In order to enable it to carry into execution the powers thus conferred it may exercise other powers, known to the law as incidental or implied powers. Implied powers exist only to enable a corporation to carry out the express powers granted, — that is, to accomplish the purpose of its existence, — and can in no case avail to enlarge the express powers, and thereby warrant it to devote its efforts and capital to other purposes than such as its charter expressly authorizes, or to engage in collateral enterprises not directly but only remotely connected with its specific corporate purposes. A power which the law will regard as existing by implication must be one in a sense necessary, — that is, needful, suitable and proper to accomplish the object of the grant, and one that is directly and immediately appropriate to the execution of the specific powers, and not one that has but a slight, indirect or remote relation to the specific purposes of the corporation. *Illinois Conference Female College* v. *Cooper*, 25 Ill. 133; *Caldwell* v. *City of Alton*, 33 id. 416; *Chicago, Pekin and Southwestern Railroad Co.* v. *Town of Marseilles*, 84 id. 643; *Chicago Gas Light Co.* v. *People's Gas Light Co.*, 121 id. 530; *Mott* v. *Danville Seminary*, 129 id. 403; *People* v. *Chicago Gas Trust Co.*, 130 id. 268; *North Side Railroad Co.* v. *Worthington* (Tex.), 30 S.W. Rep. 1055; Field on Corporations, §§ 53, 54; 4 Thompson's Law of Corp. § 5638; 2 Beach on Private Corp. § 385; Green's Brice's Ultra Vires, 88, 89.

Keeping these definitions as to implied powers in view, we may proceed to determine whether the acts set forth in the pleas are within or beyond the measure of power possessed by the appellee company.

The information charges that the defendant owns and controls within the city of Chicago a large ten-story business block, together with the ground on which said building stands, worth $2,000,000; that the defendant occupies a portion, only, of said building for purposes of its own corporation business, and that it leases about three-fourths of the building to other persons, firms or corporations, and receives a large consideration from the occupants thereof as rentals; that said block was built by the defendant as an investment, and charges that the said building was erected without warrant or authority of law. The defendant sets up by way of inducement in its plea, that it has had, ever since its organization, its general offices near the business center of the city of Chicago, and that it is necessary and proper to do so; that it became impossible to rent proper general offices, and that the rentals charged for poor offices were high and exorbitant; that thereupon, in 1880, it purchased a lot of land, 75 by 170 feet, at the corner of Michigan avenue and Adams

street, and erected thereon a building, in which it ever since has kept its general offices and some store rooms; that the said land was valuable, and could not, without great loss, be utilized for erecting a building other than a high building, and such as is in keeping with and equal to the surrounding buildings; that thereupon defendant erected thereon a nine-story building, of which it now uses nearly one-half, and that if its business continues to increase as it has in the past, it will soon also use it all for its general offices; that in the meantime it rents to different parties such offices as it is not at present using; that erecting such buildings is in keeping with the usual practice of other large corporations doing kindred business, and that it could not now rent such general offices as it requires, in the business center of Chicago, for a rental as low as five per centum per annum on the amount which said building and the land on which it stands cost defendant.

The defendant is authorized by § 6 of its charter to purchase, acquire and hold such real estate as may be necessary for the successful prosecution of its business; but it is contended that the building in question is much larger and contains many more rooms and offices than the business or wants of the corporation demand; that only a small portion of it is occupied by the company's employees; that it was erected as an investment by the company, and therefore that the company owns and maintains the building without authority of law. We are concerned, however, with the averments of the plea the truth of which are admitted by the demurrer. The plea avers it was necessary and proper the general offices of the appellee should be maintained near the business center of the city of Chicago, and that such offices have always been maintained in that locality; that it became impossible to rent suitable general offices there, and even insufficient and undesirable offices could only be obtained at high and exorbitant rentals; that the business of the company was large and rapidly increasing, and that good business judgment dictated the company should provide its own offices, and that in view of the fact that desirable ground was very valuable, and that more office room would be needed in the future to accommodate the growing business of the company, it was determined to construct a larger building than was at the time actually needed and necessary and to rent such offices as were not at the present needed, and that, moved by such consideration, the building was erected; that if the business of the corporation continues to increase as it has in the past, the entire building will soon be devoted to the uses of the company.

We think the plea presented a good defense to the charges preferred in the information with reference to this building. The right of the appellee to construct an office building is indisputable, as so, also, is the right to select the most eligible and desirable site. It would be but a narrow and wholly unjustifiable view of this power

to insist that in planning and constructing the building the corporation should leave out of consideration its probable prospective requirements, and should erect a building containing only as many rooms and offices as its present business might demand. The corporation had the right, as we think, to look to and prepare for the future. It was but true economy to do so, and if it proceeded in good faith, as we are to assume from the conceded averments of the plea it did, no reason is perceived why it should be deemed bound by law to permit such parts of the building as are not for the present required for the accommodation of its business, to remain vacant, but, on the contrary, that it might lawfully obtain such income from the rents of such rooms as might be possible until the growth or increase of its business demanded the additional rooms or offices. A corporation could not be permitted, under mere color and pretense of furnishing accommodations for the transaction of its own affairs, to construct houses or rooms for the purpose of renting the same, and engage in renting such houses or rooms as a business, if such pursuit was, as it here clearly is, beyond and distinct from that it was created to pursue and accomplish. But the averments of the plea do not justify the imputation that the acts of the company under consideration are but colorable, and in this investigation the averments stand confessed by the State.

NOTE. — See, *accord*, *Simpson* v. *Westminster Palace Hotel Co.*, 8 H.L. Cas. 712. *Cf. First Methodist Church* v. *Dixon*, 178 Ill. 260.

BROWN *v.* WINNISIMMET CO.

11 All. (Mass.) 326. 1865.

A VESSEL belonging to the defendant had, by authority of its directors, been chartered to the United States for use in the war. It had been sent to Fortress Munroe. The plaintiff claimed that certain commissions were due him for effecting this chartering by the United States. One ground of defence by the defendant was that it was *ultra vires* for it so to charter the vessel.

BIGELOW, C.J. The main defence to this action appears to have been that the contracts or agreements on which the plaintiffs rely in support of their claim against the defendants were such that the latter had no power or authority to make them under the act of the legislature by which they were incorporated, and that they cannot for that reason be enforced in a court of law. The later English authorities seem to sanction the doctrine that such a ground of defence, although it may be "unbecoming and ungracious," or, in the stronger language of Lord St. Leonards, "indecent," is nevertheless legal and

valid, if it be made to appear, either by the express provisions of an act of incorporation or by necessary and reasonable implication therefrom, that a contract which is sought to be enforced in an action at law against a corporation is beyond the scope of the powers granted by its charter; or, in other words, that the legislature did not intend that the body created by them should enter into contracts of a character like that which a plaintiff makes the foundation of a claim against it. *South Yorkshire Railway, etc.* v. *Great Northern Railway*, 9 Exch. 55, 85. *Bateman* v. *Ashton-under-Lyne*, 3 Hurlst. & Norm. 323. *Norwich* v. *Norfolk Railway*, 4 El. & Bl. 397, and cases cited. *Hawkes* v. *Eastern Counties Railway*, 1 DeG., Macn. & Gord. 737, 760. A similar doctrine has been recognized and applied by courts in this country. *Pennsylvania, etc. Steam Navigation Co.* v. *Dandridge*, 8 Gill & J. 248. *Hood* v. *New York & New Haven Railroad*, 22 Conn. 502. *Pearce* v. *Madison, etc. Railroad*, 21 How. 441. Angell & Ames on Corp. § 256, and cases cited. It is on the principle which seems to be adopted by these authorities that the defendants rely to defeat the present action.

We have no occasion now to examine at length into the correctness of this doctrine, or to ascertain with precision its proper limitations or operation, because we are of opinion that the defendants do not bring the case at bar within any recognized application of the rule. Looking only at the words of the act by which the defendants were incorporated, *St.* 1833, *c.* 197, we are unable to say that the contracts on which the plaintiffs rely are so far foreign to the object for which a charter was granted to the defendants as to require us to declare them to have been *ultra vires* and illegal, and that no action upon them can be maintained in a court of law. In the absence of all evidence of extraneous facts, and taking the case as it was presented at the trial, on a comparison of the contracts set up by the plaintiffs with the act incorporating the defendants, it appears to us that the scrupulous care and anxiety to keep within the limit of their corporate powers, which the defendants now manifest will not avail them in defence of this action, although it may induce them to exercise a greater caution in entering into contracts which they cannot fulfil without violating their charter. They were incorporated with power to establish, continue and maintain a ferry between the city of Boston and the town of Chelsea, and were authorized to own, hold and possess vessels, steamboats and such other personal property, not exceeding in value one hundred thousand dollars, as might be necessary and convenient for the better management of such ferry and of the affairs of said corporation. There can be no doubt that under this charter the main purpose for which the defendants were incorporated was to carry on the transportation of persons, vehicles, merchandise and other articles by means of a ferry across Charles River between the points designated in the act. All

else was to be subordinate and incidental to this main design. So far, the argument urged in behalf of the defendants is sound and irrefragable.

But the next step is not so easily taken, nor does it lead to the point at which the defendants seek to arrive. It was not shown at the trial that the steamboat which was the subject of the contracts with the plaintiffs was not a necessary and proper vessel to be used by the defendants in the prosecution of the business of their ferry, nor that by reason of its ownership they had exceeded the limit of personal property which they were empowered by their charter to hold. Nor could it be properly inferred that it was not reasonably required for the legitimate business of the corporation, because it was not in actual use by them on the ferry at the time the contract for letting it was entered into with the plaintiffs, and because it was chartered under that contract for the use of the government of the United States. Such an inference could be made only on the theory that the defendants were so restricted by their charter that they could not hold any greater number of vessels or steamboats than were absolutely required for present or immediate and constant use on their ferry, or, if they could be allowed to possess a larger number, that they could not use or employ them in any other business or for any other purpose whatever, but must suffer them to remain at their wharf to decay or deteriorate for the want of use, or, at least, in a condition in which they could be of no advantage to themselves or others. But we think such a narrow and restricted construction of the powers granted to the defendants is inconsistent with any reasonable view of the intention of the legislature in conferring on them a corporate franchise, and is not required by any considerations of justice or sound policy. On the contrary, we cannot doubt that under their charter they are authorized to hold any amount or kind of personal property, within the limit of value fixed by the act, which they may deem necessary or expedient for the proper conduct and management of the business of the ferry; that it is no excess of their corporate powers to own steamboats which are not required for immediate or constant use in the daily prosecution of their ordinary business, but which may be convenient or useful in case of sudden emergency or accident, or when those which are employed in the regular service of the ferry might be withdrawn for repairs; that it is not necessary that such extra or additional steamboats should be kept unemployed when not required for the business of the ferry, but that it is competent for the defendants to use them or to let them to others to be used in carrying on any legitimate business for which they are suitable, such as the towage of vessels and the transportation of passengers or merchandise, so long as such use is only temporary and incidental to the main purpose for which they are owned by the defendants.

We know of no rule or principle by which an act creating a cor-

poration for certain specific objects or to carry on a particular trade or business is to be strictly construed, as prohibitory of all other dealings or transactions, not coming within the exact scope of those designated. Undoubtedly the main business of a corporation is to be confined to that class of operations which properly appertain to the general purposes for which its charter was granted. But it may also enter into contracts and engage in transactions which are incidental or auxiliary to its main business, or which may become necessary, expedient or profitable in the care and management of the property which it is authorized to hold under the act by which it was created. For example, it might perhaps be held that a corporation established for the purpose of manufacturing cotton and woollen cloth could not properly invest all its capital in mill powers and privileges, and engage exclusively in the business of leasing them to others to be used for manufacturing purposes, or that it could not lawfully confine its operations to the making of steam-engines and machines for sale. But no one could doubt that it would be within the scope of its powers to allow another person or corporation, for a reasonable compensation, to draw surplus water from its mill-pond, or to employ that portion of its steam power which was not required for its own use. So a stage-coach company or a street railway corporation would exceed its corporate powers if it engaged extensively in the transportation of passengers and merchandise on land or sea by steam; but it would be acting strictly within the limits of its capacity if it should occasionally let a horse or a coach or car, not required for its own immediate purposes, to another person or corporation, or should enter into a contract for the employment of its horses in another occupation during a portion of the year when the business of the corporation did not require their use. We can see no substantial difference between transactions of this character and that which the defendants entered into when they made the contracts with the plaintiffs.

These views of the extent of the authority granted to the defendants by the legislature are a decisive answer to the defence relied on by them at the trial. The steamboat, under the contract with the plaintiffs, was let to the United States in a season of great public exigency, for military purposes; the defendants did not part with her control for any definite period of time, but only from day to day, nor did they send her to a great distance, where she could not be speedily recalled. The defendants retained the right and power to resume the possession and use of her at any moment. In this state of facts, we are of opinion that the court below took a correct view of the law, and was right in refusing to rule, as requested by the defendants, that the contracts entered into with the plaintiffs were not authorized by the defendants' charter, and were therefore void.

NOTE. — See, *accord, Forrest* v. *Manchester Ry. Co.*, 30 Beav. 40.

WILLIAMS *v.* JOHNSON.

208 Mass. 544. 1911.

KNOWLTON, C.J. This is an appeal from a decree of the Land Court granting a petition for the registration of the title to a tract of land in Boston, a part of which was formerly occupied as the station of the Boston and Providence Railroad Company, at Park Square. The diversion and extension of the railroad and the erection of the terminal passenger station in Boston under the St. 1896, chap. 516, rendered the property no longer available for railroad purposes, and it was conveyed by this corporation to the New York, New Haven, and Hartford Railroad Company in consideration of improvements made by the grantee upon the property of the grantor, in connection with the location and erection of the new station. The validity of this conveyance was confirmed in *Little* v. *Old Colony Railroad*, 202 Mass. 277. The petitioners claim title under a deed from the New York, New Haven, and Hartford Railroad Company, bearing date September 15, 1909. The respondents, who are stockholders in the last mentioned corporation, deny the validity of the deed, on the ground that it was *ultra vires* of the corporation and that the directors had no authority to make it.

The deed runs to the petitioners as trustees under a declaration of trust. The consideration expressed in it is $1 and other valuable considerations. The conveyance is "subject to and upon the terms, provisions and trusts mentioned and set forth in the aforesaid declaration of trust." This declaration is of a peculiar kind. It provides that the trustees shall forthwith issue to the grantor certificates, in a form prescribed, for fifty-two thousand shares, of a nominal par value of $100 each, in payment for this real estate. The entire interest of the *cestuis que trust*, or shareholders in the property, was to be represented, immediately after the conveyance, by these shares. The trustees were authorized to issue not exceeding forty thousand additional shares of the same nominal par value, in exchange for convertible notes or bonds that the trustees may issue to obtain money to be used in conducting the enterprise. The shares are transferable on the books of the trustees. The shareholders are not to have any legal title to the trust property itself, real or personal, and especially they are not to have a right to call for any partition. It is declared that they shall have no equitable estate in the lands and appurtenances constituting the trust property, but their interest shall consist only of an interest in the money to arise from the sale or other disposition thereof by the trustees, and, previously to such sale, in all the rights mentioned in the declaration, which are rights "of division of proceeds and profits and the other rights and matters concerning the trust property."

The death of a shareholder is not to determine the trust, nor entitle his legal representatives to an accounting, but his rights are to pass to his executors, administrators or assigns, upon the surrender of the certificate of the shares. The trustees may from time to time invite and receive subscriptions to additional shares, for the purpose of increasing the capital of the trust, giving preference, upon such terms and conditions as they shall deem best, to existing shareholders, and to the holders of convertible notes or bonds. The trustees have no power to bind the shareholders personally for any debt, nor are the trustees to be personally liable for claims or debts against the trust, but all persons extending credit to the trustees are to look only to the property of the trust for their payment. The trustees have no pecuniary interest in the property of the trust, or in the business carried on under the trust, except for the payment of prescribed commissions upon receipts and expenditures, as compensation for their services.

The trustees are to have absolute control over and disposal of all real estate and other property held under the trust, including the power to improve it by building thereon or otherwise; to sell, for cash or credit, at public or private sale, any part of the property; "to lease or hire for improvement or otherwise, for a term beyond the possible termination of this trust, or for any less term, to let, to exchange, to release and to partition." They have power to borrow money to carry out the purposes of the trust, to issue notes or bonds, and to secure the repayment of them by a pledge, mortgage or hypothecation of the property of the trust, or any part of it. The only limitation upon the power to borrow is that the total indebtedness at any one time shall not exceed $4,000,000. Notes or bonds issued for such indebtedness may be made convertible into shares of the trust.

The trustees may acquire, by purchase or otherwise, any real estate or any interest therein in the vicinity of that conveyed by the deed in question, "and any notes, bonds, shares or other securities of any corporation, association or real estate trust, organized or adapted for the purpose of acquiring, holding, managing or improving real estate, or for the purpose of conducting a lighting, heating, power or other business directly related to the management of real estate, if in their judgment such acquisition will in any manner tend to facilitate the laying out, development, management or improvement of the real estate" conveyed to them by the deed in question. They may lay out and construct or discontinue streets or ways, upon any property at any time held by them. They may dedicate to public use, or convey to the city of Boston, with or without compensation, any part of the property, with a view to the enhancement of the value of the remaining property. For a like purpose they may contribute money or other property to the cost of any

public or quasi public undertaking. In all these matters the judgment and determination of the trustees is to be final and conclusive.

They may from time to time determine what of their receipts and expenditures shall be treated as capital and what as income, and their determination shall be final. They may divide net income among the shareholders, under certain limitations, and may set aside a part of the net income as a reserve or contingent fund. Their determination of what is net income is to be conclusive. The trust is to continue until the expiration of twenty years from the death of the last survivor of nine persons named, some of whom, presumably, are quite young, unless three fourths in value of the shareholders shall appoint an earlier time for its termination, not earlier than the second day of July, in the year 1919, by an instrument in writing duly signed and acknowledged. After the termination of the trust by its own limitation, or by such an appointment of three fourths of the shareholders, the proceeds are to be divided among the shareholders. The trustees, when vacancies occur in their number, may appoint their own successors.

By this conveyance and the accompanying declaration of trust, the New York, New Haven, and Hartford Railroad Company set on foot a scheme to put property, of an estimated value of more than $5,000,000, into the hands of trustees as managing agents, who were appointed irrevocably, to conduct a business for a term that might last nearly a century, with practically all the powers of an absolute owner, not only over the property conveyed, but for the acquisition of other real estate in the neighborhood, and of shares in corporations which have relation to the use, management and improvement of real estate. The scheme contemplates the borrowing of money to create an indebtedness not exceeding $4,000,000 at any one time. It contemplates an unlimited extension and enlargement of the enterprise, in the discretion of the trustees, by the issue of additional shares to persons who subscribe for them. It contemplates a real estate business, if not a speculation, that may continue a long time and become gigantic, of which the railroad corporation is now the sole owner. It needs no argument to show that, ordinarily, the proprietorship of such a business, by a railroad company as a beneficiary, is not within its corporate powers.

As was said in *Davis* v. *Old Colony Railroad*, 131 Mass. 258, 259, "A corporation has power to do such business only as it is authorized by its act of incorporation to do, and no other. It is not held out by the government, nor by the stockholders, as authorized to make contracts which are beyond the purposes and scope of its charter. It is not vested with all the capacities of a natural person, or of an ordinary partnership, but with such only as its charter confers." In *Waldo* v. *Chicago, St. Paul & Fond du Lac Railroad*, 14 Wis. 575, 581, we find this language: "When a corporation, created for

the purpose of building and operating a railroad, goes into the business of banking, or manufacturing and selling goods, or dealing and speculating in real estate, because its corporators or board of directors think such adventures may be profitable, or if a bank should go to building and operating a railroad for like reason, it is easy to see that in each instance the corporation is attempting to transact business which, under its organic act, it has no right or power to do. And if the corporation might embark in a separate and distinct business, not contemplated by its charter, merely because it was supposed it would be profitable and increase its means and resources, there would be no safety to the public in granting any special charters, and none to individuals who might invest in the stock of the company." The following are a few among the many other cases that apply the same doctrine: *Attorney General* v. *Great Northern Railway*, 1 Dr. & Sm. 154; *Case* v. *Kelly*, 133 U.S. 21; *Pacific Railroad* v. *Seely*, 45 Mo. 212; *State* v. *Southern Pacific Co.*, 52 La. Ann. 1822; *Chicago* v. *Cameron*, 120 Ill. 447; *People* v. *Pullman's Palace Car Co.*, 175 Ill. 125; *Slater Woolen Co.* v. *Lamb*, 143 Mass. 420.

If the railroad company had taken its money and purchased land, and had applied it to a use like that contemplated by this scheme, no one would contend that it was acting within the law. We are left with only the question whether its ownership of this real estate justifies its creation of such an enterprise.

Its ownership of the land, which came to it legitimately, left it with the property on hand, to be sold or disposed of, so that its proceeds could be properly used for the purposes for which the corporation was created. It did not give it the right to hold the land permanently, or for an unreasonably long time, as an investment for the production of income; much less did it give it the right to carry on, for a long term of years, the business of speculating in land, or developing this and other land in the vicinity, and changing its general character, for the purpose of gain. If the corporation could not do this directly, it could not do it indirectly through the appointment of trustees or agents who should continue the business for its benefit. *Attorney General* v. *New York, New Haven, & Hartford Railroad*, 198 Mass. 413.

The objection to such a venture on the part of a corporation is twofold. On the part of the State it is that the corporation is usurping powers which were never conferred upon it, and is engaging in a business which the Legislature has not authorized it to do, and to which there may be grave objections on grounds of public policy. The trustees are managing for this corporation, as the beneficiary, a large amount of valuable real estate in the heart of Boston, and are authorized, in the interest of the beneficiary, to make donations of land or other property for public purposes, or to convey it to the city of Boston with or without compensation, to lay out and con-

struct or to discontinue streets, and become the owners of corporations engaged in other kinds of business relating to real estate, even in remote parts of the city. There may be grave reasons connected with the public interest why such powers should not be exercised in a city, and, incidentally, an influence possibly be exerted in behalf of a great railroad corporation. At all events, the Legislature has never seen fit to authorize their exercise. Corporations for the holding of real estate for purposes of profit have always been deemed objectionable, and the general laws of this Commonwealth do not permit the organization of such corporations.

The other objection is from the side of the stockholder in the corporation. He invests his money by subscribing for the shares of stock, with a knowledge of the purpose for which the corporation is organized, and with a view to the probable gain, and a thought of the possible loss, that may result from the transaction of the business of the corporation. He does not invest in any other kind of enterprise than that which is within the authority conferred upon the corporation. His protection requires that the company be confined strictly to the business and functions for which it was organized. It would leave him without compass or rudder in making his investment, if the managing officers, or a majority of the stockholders, could use the corporate property in a business foreign to that for which the company was established.

In turning this real estate into money, the railroad company should not be held too strictly to sales to be made at once and without expenditure for changes and improvements that would increase its marketable qualities. A reasonable latitude in that respect is fairly incidental to ownership with a right to sell. *Dupee* v. *Boston Water Power Co.*, 114 Mass. 37. But nothing more than what is fairly incidental to a reasonable disposition of the property for its fair market value, within a reasonable time, is permissible.

The only debatable question in this case is whether such a scheme as has been devised is incidental to the right to sell, and reasonably necessary to enable the corporation to obtain the fair market value of the property. We are of opinion that it is not.

The reasons relied on by the petitioners for adopting the scheme, as given in the statement of agreed facts, are that "earnest efforts during several years were made, without success, to sell the same and convert it into cash, but the risks and uncertainties attending the development and use of so large a tract of land, without streets or other facilities for its development, were such that no purchaser was in fact found, and no purchaser seemed likely to be found, willing and able to purchase said property, except at a price so low as to indemnify him against all such risks and uncertainties and much below the estimated real value of said land." This is, in substance, that the directors have not been able to sell the land for its estimated

value, and that there are risks and uncertainties attending the development and use of the land, which a purchaser would take into account in determining what price he would pay for it. The directors decided to put these risks and uncertainties upon the stock-holders of the corporation, by providing for a business of developing and using this property for many years, in the belief, doubtless, that the business would be more profitable than a sale to others who would assume the risks of such a business. This is not very different from taking $5,000,000 in money of the corporation, if that amount happened to be on hand, and if land could be bought for its fair market value, and investing the money in such an enterprise, in the expectation that the assumption of these risks and uncertainties, in buying at a price diminished on account of them, would open a large field for profit in the business of developing and using the property.

The conveyance to the trustees merely changed the form of the property. It did not bring a dollar to the treasury of the corporation. If the trust were sustained, it might or might not be possible, at some time, to sell shares at their estimated value instead of selling portions of the land. But, presumably, there will be no satisfactory market for any of these shares, unless it is demonstrated, after a considerable time, that the business is likely to prove profitable.

Petition dismissed.

FRANKLIN NATIONAL BANK *v.* WHITEHEAD.

149 Ind. 560. 1898.

MONKS, J. The first question to be determined is whether the Greenfield Iron and Nail Company was authorized to engage in the business of public warehouseman, and as such issue warehouse receipts.

The special finding shows that said Greenfield Iron and Nail Company was organized under the laws for the incorporation of manufacturing and mining companies, and that its object, as stated in the articles of association, was to manufacture and sell nails and other products of steel and iron. A corporation possesses only such powers as are expressly given by law, and such implied powers as are necessary to enable them to exercise the power expressly given. *State Board of Agriculture* v. *Citizens Street R.W. Co.*, 47 Ind. 407, 409; Clark on Corp., 120. The business of public warehouseman was not necessary or incidental to the business of said company in manufacturing or selling nails or other products of steel or iron. It is evident that such company was not authorized, by the laws under which it was organized, to engage in the business of public warehouseman or to issue warehouse receipts.

It is insisted, however, by appellants, that as said company made a written application to the auditor of Hancock county and obtained a permit from him to carry on the business of public warehouseman under the provisions of § 8704, Burns' R.S. 1894 (6525, Horner's R.S. 1897), it was fully authorized, by said section, to carry on that business and issue warehouse receipts.

The section referred to is the first section of the public warehouse act of 1875, as amended in 1879, and the part relied upon by appellants is as follows: "Any person or incorporated company desiring to keep any such public warehouse shall be entitled to do so upon receiving a permit therefor from the auditor of the county in which such warehouse shall be kept." § 8704, Burns' R.S. 1894. If appellants' construction of said section is the correct one, then all the corporations in the State, whether educational, charitable, religious, commercial, or otherwise, whatever may be the provisions of the law under which organized, are given the right of going into and carrying on the business of public warehousemen. While the language quoted from said section is very broad, it was certainly not the intention of the legislature to confer on all the corporations in the State, without regard to the law under which they were organized, and the purposes and objects of their organization, the privileges of public warehousemen. As well hold that persons without capacity to contract on account of infancy, insanity, or other disqualifications were, by said statute, authorized to engage in the business of public warehousemen and execute valid warehouse receipts.

A warehouseman is defined to be the owner of a warehouse; one who, as a business and for hire, keeps and stores the goods of others. (Black's Law Dictionary.) A person who receives goods and merchandise to be stored in his warehouse for hire. (Bouvier's Law Dictionary); 28 Am. and Eng. Ency. of Law, 636, 637; Edwards on Bailments, § 332; Hale on Bailments, 238.

Only such corporations as are authorized by the law under which they are organized to carry on the business of warehouseman can avail themselves of the provisions of said act of 1875 (Acts 1875, p. 172), as amended by the act of 1879 (Acts 1879, p. 230), being §§ 8704, 8719, Burns' R.S. 1894 (6525, 6540, Horner's R.S. 1897). It follows that said nail company was not authorized to operate as a public warehouseman, or issue any warehouse receipts under the provision of said act of 1875, as amended by the act of 1879.

NOTE.

Section 4 of chap. 437 of the Acts of 1903 of Massachusetts (the Business Corporation Law) is set forth below.

"Section 4. Every corporation which is subject to the provisions

of this act shall have the following powers and privileges and shall be subject to the following liabilities: —

"(*a*) To have perpetual succession in its corporate name, unless a period for its duration is limited by special law.

"(*b*) To sue or be sued in its corporate name, and to prosecute or defend to final judgment an execution or decree in any court of law or equity.

"(*c*) To have a capital stock to such an amount as may be fixed in its agreement of association or articles of organization or of amendment as hereinafter provided.

"(*d*) To have a corporate seal, which it may alter at pleasure.

"(*e*) To elect all necessary officers, fix their compensation and define their duties.

"(*f*) To hold, purchase, convey, mortgage or lease within or without this commonwealth such real or personal property as the purposes of the corporation may require.

"(*g*) To make contracts, incur liabilities and borrow money on its credit and for its use.

"(*h*) To make by-laws not inconsistent with the laws of this commonwealth for regulating its government and for the administration of its affairs as hereinafter provided.

"(*i*) To be dissolved or to have its affairs wound up in the manner hereinafter provided."

A corporation has power to take a fee in land, although its corporate existence is limited to a definite number of years. *Nicoll* v. *New York & Erie R.R. Co.*, 12 N.Y. 121. Similarly of a franchise for a number of years longer than that limiting the corporate existence. *Owensboro* v. *Cumberland Tel. Co.*, 230 U.S. 58.

It may issue negotiable instruments for a proper consideration. *Bradbury* v. *Boston Canoe Club*, 153 Mass. 77. (In England, a more cautious statement would have to be made, as some corporations have no power to issue negotiable instruments.) But not for accommodation. *Owen & Co.* v. *Storms & Co.*, 78 N.J.L. 154.

SECTION 2.

TO ENTER INTO A PARTNERSHIP.

WHITTENTON MILLS *v.* UPTON.

10 Gray (Mass.) 582. 1858.

Petition by the Whittenton Mills, a manufacturing corporation, to set aside proceedings in insolvency, instituted against it and William Mason, as partners, upon Mason's petition. The directors of the corporation, and Mason, had assumed to form a partnership between the corporation and Mason, and business had been conducted and liabilities occurred which were in form the liabilities of such partnership.

Thomas, J. Was this corporation capable of forming a partnership, of entering into the contract? This question presents itself in two forms. The more general one is: Has a corporation, as one of its usual inherent powers, the capacity to form a contract of copartnership? The narrower question, but for this case the practical and pertinent one, is, Can a manufacturing corporation in this commonwealth, incorporated since February 1831, and subject to the provisions of the thirty-eighth and forty-fourth chapters of the revised statutes, enter into a contract or society of copartnership?

This corporation was created in March 1836 as a manufacturing corporation, for the purpose of manufacturing cotton goods in the town of Taunton, and for that purpose was invested with all the powers and privileges and made subject to all the duties, restrictions and liabilities set forth in the thirty-eighth and forty-fourth chapters of the revised statutes, passed on the fourth of November preceding, but not to take effect till the first of May eighteen hundred and thirty-six. St. 1836, chap. 19. This charter, with the provisions of the chapters referred to and made part of it, is the origin and source of the powers and functions of the corporation. What powers are granted expressly, or by implication, because necessary or usual for the purposes which this charter was given to effect, the corporation has, and no more.

There is one obvious and important distinction between such a society as this charter creates and that of a partnership. An act of the corporation, done either by direct vote or by agents authorized for the purpose, is the manifestation of the collected will of the society. No member of the corporation, as such, can bind the society. In a partnership each member binds the society as a principal.

If then this corporation may enter into partnership with an individual, there would be two principals, the legal person and the natural person, each having, within the scope of the society's business, full authority to manage its concerns, including even the disposition of its property.

The second section of chap. 38 of the Rev. Sts. provides that the business of every such manufacturing corporation shall be managed and conducted by the president and directors thereof and such other officers, agents and factors as the company shall think proper to authorize for that purpose. It is plain that the provisions of this section cannot be carried into effect where a partnership exists. The partner may manage and conduct the business of the corporation, and bind it by his acts. In so doing he does not act as an officer or agent of the corporation by authority received from it, but as a principal in a society in which all are equals, and each capable of binding the society by the act of its individual will.

Indeed, in examining this chapter, it will be found that there is scarcely a provision for the conduct of the business of a manufacturing corporation that is not inconsistent with the existence of a contract by which the power to manage the business of the company and to bind the corporation by his acts is vested in one not a member of the corporation nor its officer or agent. Such are the third, fourth and fifth sections, providing how the president and directors, and other officers, agents and factors of the corporation shall be chosen. Such too is the sixth section, which authorizes every such company to make by-laws for its own regulation and government. Such are the several provisions authorizing the stockholders to fix the amount of the capital stock, to increase the same within the limit fixed by law or to reduce it. §§ 9, 11, 19. And such is the provision requiring the president and directors to give annual notice of the amount of the debts of the corporation; the means of stating which would not be in their power if another principal had the power of creating the debts. § 22. Of the same character is the twenty-fifth section, by which it is declared that the whole amount of the debts which the corporation shall at any time owe shall not exceed the amount of the capital stock actually paid in, and which renders the directors, under whose administration an excess shall occur, liable personally to the extent of such excess; a provision evidently based upon the ground that the exclusive power to contract debts is vested in such directors, and that they cannot be divested of it, and which is wholly inconsistent with the existence of a power in the corporation to enter into a contract of partnership, by which another principal would be created, having equal power to contract debts and to bind the partnership and the corporation *in solido*.

Indeed the effect of all our statutes, the settled policy of our legislature, for the regulation of manufacturing corporations is that the

corporation is to manage its affairs separately and exclusively; certain powers to be exercised by the stockholders, and others by officers who are the servants of the corporation and act in its name and behalf. And the formation of a contract, or the entering into a relation, by which the corporation or the officers of its appointment should be divested of that power, or by which its franchises should be vested in a partner with equal power to direct and control its business, is entirely inconsistent with that policy.

The power to form a partnership is not only not among the powers granted expressly or by reasonable implication, but is wholly inconsistent with the scope and tenor of the powers expressly conferred, and the duties expressly imposed, upon a manufacturing corporation under the legislation of the commonwealth.

[The prayer of the petition was granted.]

NOTE. — See, *accord, Gunn* v. *Central R.R.*, 74 Ga. 509; *Bishop* v. *American Preservers' Co.*, 157 Ill. 284; *White Star Line* v. *Star Line*, 141 Mich. 604; *Burke* v. *Concord R.R.*, 61 N.H. 160; *People* v. *North River Sugar Refining Co.*, 121 N.Y. 582, *supra; Boyd* v. *American Carbon Black Co.*, 182 Pa. 206; *Huguenot Mills* v. *Jempson*, 68 S.C. 363; *Mallory* v. *Hanaur Oil Works*, 86 Tenn. 598; *Pearce* v. *Madison R.R. Co.*, 21 How. (U.S.) 441.

Cf. Allen v. *Woonsocket Co.*, 11 R.I. 288.

But such power may be given by the legislature. *Butler* v. *American Toy Co.*, 46 Conn. 136.

BATES *v.* CORONADO BEACH CO.

109 Cal. 160. 1895.

ACTION for an accounting upon a partnership agreement.

The plaintiff alleged that a contract had been made between the defendant and himself by which it was agreed that they should purchase certain lands and other property, sell the same, pay certain debts and encumbrances thereon, and divide the profits and losses arising therefrom equally between them. The plaintiff paid and conveyed to the defendant his contribution in money and land. The defendant used the money in discharging obligations upon the land, and afterwards disposed of the land.

HARRISON, J. It was not *ultra vires* for the appellant to enter into the agreement with the plaintiff. The power of a corporation to enter into a general partnership with an individual, or with another corporation, is not here involved. The ground upon which this power is sometimes denied is that a partnership implies the power of each partner, under his authority as a general agent for all the purposes of

the partnership, to bind the others by his individual acts, whereas the statutes under which a corporation exists require its powers to be exercised by a board of directors, and preclude it from becoming bound by the act of the one who may be only its partner. There is, however, in the present case no question of agency in the management of the affairs of the corporation. The plaintiff paid the money to the appellant, and transferred to its appointee the title to the land, so that the entire management of the business contemplated by the contract was intrusted to the corporation itself. There is no rule of law that will preclude a corporation from entering into a contract with an individual, which will have the effect to carry out directly or indirectly the object of its incorporation, and to provide in that agreement that the gains or losses of the venture shall be borne equally by both parties. Section 354 of the Civil Code provides: "Every corporation, as such, has the power: . . . 8. To enter into any obligations or contracts essential to the transaction of its ordinary affairs, or for the purposes of the corporation."

NOTE. — Traffic agreements between railroad corporations to handle through business are not objectionable as making a partnership between the railroads. See *Chicago & Alton R.R. Co.* v. *Mulford*, 162 Ill. 522, 533; *Najac* v. *Boston & Lowell R.R. Co.*, 7 All. (Mass.) 329.

See also *Hackett* v. *Multnomah Ry. Co.*, 12 Or. 124.

SECTION 3.

TO HOLD STOCK IN OTHER CORPORATIONS.

DENNY HOTEL CO. *v.* SCHRAM.

6 Wash. 134. 1893.

DUNBAR, C.J. Can a corporation under the laws of this State become an incorporator by subscribing for shares in another corporation?

A corporation can only be formed in the manner provided by law and has only such powers as the law specifically confers upon it. We do not think that a corporation was within the contemplation of the legislature when they used the expression "two or more persons," in § 1498, Gen. Stat. It is true that § 1709, Code Proc., provides that the term "person" may be construed to include the United States, this state, or any state or territory, or any public or private corporation, as well as an individual. But it does not follow, by any means, that the term "person" is always to be construed as a private corporation any more than it is always to be construed as the United States.

Morawetz on Private Corporations, § 433, says: "A corporation cannot, in the absence of express statutory authority, become an incorporator by subscribing for shares in a new corporation; nor can it do this indirectly through persons acting as its agents or tools;" citing *Central R.R. Co.* v. *Pennsylvania R.R. Co.*, 31 N.J. Eq. 475. The author, continuing, says: "The right of forming a corporation is conferred by the incorporation laws only upon persons acting individually, and not upon associations."

This, it seems to us, for manifest and manifold reasons, is in accordance with public policy; and we therefore decide that under the existing laws of this state one corporation cannot subscribe to the capital stock of another corporation.

NOTE. — See, *accord*, *Knowles* v. *Sandercock*, 107 Cal. 629, 642; *Mechanics Association* v. *Meriden Agency Co.*, 24 Conn. 159; *Franklin Co.* v. *Lewiston Institution for Savings*, 68 Me. 43; *Central R.R. Co.* v. *Pennsylvania R.R. Co.*, 31 N.J. Eq., 475, 494; *Railway Co.* v. *Iron Co.*, 46 Ohio St. 44; *McCampbell* v. *Fountain Head R.R. Co.*, 111 Tenn. 55, 67.

CENTRAL RAILROAD COMPANY *v.* COLLINS.

40 Ga. 582. 1869.

THE Central Railroad and Banking Company was chartered to build and maintain a railroad from Savannah to Macon. Its officers proposed to purchase with its funds and for its benefit 12,383 shares in the Atlantic and Gulf Railroad Company, a company chartered to build a railroad from Savannah to Bainbridge, with intent to use the stock to affect the management of the Atlantic and Gulf Road. Certain stockholders of the Central Railroad and Banking Company sought to restrain this, and alleged that such a purchase would be *ultra vires*. The defense was that the Atlantic and Gulf Road was so managing its affairs, in carrying freights at various rates from Bainbridge, as materially to injure the Central Railroad Company, and that the intent of the purchase was merely to enable the Central Railroad Company to protect itself; that it was, in truth, necessary for self-preservation, and that the power to make it was derivable from the expressly granted power to maintain its own road.

McCAY, J. But it is said that the power to purchase this stock is derivable from the power expressly given to "maintain the road;" that it is necessary for the self-preservation of the road, and arises by *implication* from the very purposes and objects for which the charter was granted. The basis of this argument is that it is necessary for the "maintaining" of the Central Railroad, that it shall take a decided part in the "management and maintaining" of the Atlantic and Gulf Railroad, and as by the admitted rules of the common law, a corporation may make all contracts necessary, either directly or incidentally, to enable it to effect the purposes of its creation, therefore it has the power to purchase enough of the stock of the Atlantic and Gulf Railroad to enable it to protect itself by controlling the unwise management of the Atlantic and Gulf Railroad.

The purposes of the charter of the Central Railroad are the "laying, building and making" the road. The words of the charter do not in express terms include the "maintaining and sustaining" it, but we do not doubt they are included, since the "maintaining and sustaining" are necessary to the very objects of the grant. But what does a grant to maintain and sustain a railroad include? Can it in any fair sense be construed to authorise the engaging in any enterprise which will extend the business or lessen the rivalries of the company? If this be so, the whole doctrine so frequently and so emphatically stated in the books and decisions is a sham. The "maintaining and sustaining" of the road, has reference to keeping it in repairs, supplying it with machinery, and such like acts, and not to projects for extending its business, by schemes and enter-

prises not contemplated and expressed in clear, unambiguous terms, by the charter itself.

Every charter of a private corporation is a contract, first between the State and the corporation — to which each is solemnly bound — the State that it will not impair the obligation — the corporation that it will perform the objects of its incorporation and keep within the powers granted to it: 4th Wheaton, 518; secondly, between the stockholders themselves. The stockholders are bound to consent to the management of the affairs of the corporation by the majority, and by the by-laws which that majority makes. And the whole, on the other hand, agree with each other, that they will apply the funds of the company to the *objects and purposes of the charter*, and not otherwise: *Young* v. *Harrison*, 6 Ga. 130. Both as to the State and between the corporators, the law of this contract is the charter. The State has granted to it no rights, and the individual stockholders have clothed it with no rights, except such as are clearly and expressly set down in the charter: 13 Penn. 133; 28 Penn. 352; 18 Howard, 341.

Corporators are too apt to forget this fundamental law of their being. In the daily habit of transacting business, in the name of the company as though it were an individual, they are apt to slide into the notion that a corporation *is* an individual in all respects, so far as business matters are concerned.

But a corporation is a mere creature of the law, and only exists at all, for the *purposes* declared in its charter, and has absolutely no powers but those which the law *confers* upon it. It is a creation of the law, and in the very nature of things is just what the law makes it, no more, no less; and by the word law here, I do not mean the general law which regulates the powers of persons, but the act of incorporation, the charter, the constitution.

There are certain general rules which have, time out of mind, been adopted by the courts in their investigation of the powers of incorporations, that it may be well to notice. 1st. As a corporation is the *mere* creature of the act of incorporation, it has no other powers except such as are in said act expressly granted, or are necessary to effect the *ends* and objects of its existence. 2d. Charters being private acts, or rather contracts between the public and individuals, the charter is to be strictly construed, nothing is to be taken by intendment or inference. Being a creature of the law, it is made up of just such rights as its charter gives it; not that every power which it possesses must be granted in detail, but it is confined in its operations, to the objects and purposes expressly set forth in its charter, and it can undertake no other enterprise than is there expressly mentioned: *Frederick et al.* v. *City Council of Augusta*, 5 Ga. 561; *Mayor, etc.* v. *Macon & W. R.R. Co.*, 7 Ga. 221; 8 Ga. 23; 9 Ga. 213; *Winter* v. *Mus. R.R.*, 11 Ga. 438.

The books are full of decisions in illustration of these positions. In the case of the *East Anglian Railroad Company* v. *Eastern Counties Railroad Company*, 7 English Law and Equity Reports, 505, the charter was for the "purpose of making and maintaining" a particular railway. The company had leased another railway, and had covenanted to pay the costs of soliciting bills then pending in Parliament, by which the other railway should have power to make extensions and branches, and the action was for a breach of the covenant to pay said costs. JERVIS, Chief Justice, in deciding the case, says: "It is clear the defendants have a limited authority only, and are a corporation only for the purpose 'of making and maintaining' the railway sanctioned by the Act, and that their funds cannot be applied for any other purpose than that directed by the act. Indeed, it is not contended that a company so constituted can engage in new trades not contemplated by their act, but it is said they may embark in other undertakings, however various, provided the object of the directors be to increase the profit of their own railway. This is in truth the same proposition in another form; if the company cannot carry on a new trade, because it is not contemplated by the act, they cannot embark in other undertakings not sanctioned by the act, merely because they hope the speculation may ultimately benefit the stockholders."

In *Wood* v. *Greenville and Raleigh Plank Road Company*, 3 Jones' Equity (North Carolina Reports) 183, when a company was chartered "to build a plank road from Greenville to Raleigh," the court at the suit of a stockholder restrained the company from using the funds of the company to buy stages and horses, to establish a mail route over the road.

In *Coleman* v. *Eastern Counties Railway*, 6 English Railroad Cases, 573, it was held that the directors of a company have no right to pledge the funds of the company in support of any project not pointed out by their charter, although such project may tend to increase the traffic upon the railway though a *majority* of the stockholders may have consented and the object be not contrary to public policy.

In the case of *Solomons* v. *Lang*, 14th Jurist for December, 1840, the company had power by its charter to "build and maintain" a railway. In a certain legal and legitimate way, under the charter, the company became possessed of certain shares in another railway. Subsequently, it undertook to *purchase other shares* in the same company. Lord LANGDALE, M.R., held that this was an *unauthorized* application of the funds of the company.

This court in *Mayor, etc.* v. *Macon and Western Railroad*, 7 Ga. 221, held that it was not in the power of the Macon and Western Railroad, chartered to carry passengers, etc., from Macon to Atlanta, to undertake to transport produce *through* Macon, across the bridge, to the Central Railroad depot.

In *Merritt* v. *The Shrewsbury & Chester Railway*, the company undertook to improve the navigation of the river Dee, upon which, by their charter, they had wharves and warehouses, and upon which also came much of the freight carried upon the road, but the court held such an undertaking *ultra vires:* 3 Eng. L. &. E.R. 149. In 16th English Law & Equity Reports, 180, it was held that a railroad company could not contract to pay the expenses of a managing committee of a new railway company in application to Parliament for a charter. See also *E. A. R.R. Co.* v. *The Eastern Counties Railway Co.*, 21 L. Rep. (N.S.) and the court say they are a corporation only for the purpose of making and maintaining the Eastern Counties Railway, and they cannot engage in a new trade. See, also, 10 Beavan, 1; 6 Railway Cases, 152; 43 N.H. 5115.

These cases all proceed upon the well-established principle that a corporation has no powers except those expressly granted by its charter, and such as are necessary to the *declared* objects of the grant, that the charter is to be strictly construed, and that the capital stock, credit and property of every kind, is to be used solely for the purposes and objects of the charter. So long as a company confines itself within the "purposes and objects declared by the charter," the courts will sustain it, but when it undertakes new and distinct enterprises not declared in the charter, under a pretence that they are in furtherance of the declared design, the courts will restrain them. The power to do acts and make contracts necessary to enable a corporation to answer the ends of its creation, like the express grants of power, is also to be strictly construed, and is limited by all the cases and by the general principles of all the books, with this qualification, that even for this purpose it cannot engage in any new and distinct enterprise, involving new risks to its stockholders, and not fairly within the terms of the original grant: 18th How. 341, 485; 2 Russ. & My. 480, 470; 4 Railway Cases, 492; 7 Hare Chan. R. 114; 4 My. & Craig, 134; 1 Edwards, 84; 22 N.Y. 274; 13 Eng. Law and Equity, 513; 4 Russ. 562; 1 Black (U.S.) 449. The purchase of stock in another railroad company with intent to hold it, and especially, as is admitted by the answer in this case, with intent to use the power thus acquired to secure an interest in the management, either for good or evil, of the road, seems to come exactly within the principles which we have deduced from an unbroken series of decisions both in England and this country.

If the Central Railroad Company may lawfully buy twelve thousand three hundred and eighty-three shares in this road, it may lawfully buy all the shares, become the owner of the road, and thus, without any grant from the State of Georgia, *this* company may have power to manage and maintain *two* railroads from Savannah to the interior of the State. Nay, the same principles precisely which would derive from its charter this power, would authorize it to be-

come the owner of every railroad in the State, and of every other corporation and enterprise in the State, the management of which may in any way affect the interest of the Central Railroad Company. We do not think the stockholders of the Central Railroad Company, by their subscription, bound themselves to any such indefinite and unlimited enterprise. They contracted to give to the majority of the stockholders a control over their funds, for the purpose of making and keeping up and using a railroad from Savannah to Macon, and the appropriations of the capital, or credit, or funds of the company in any other enterprise, against the consent of any of the stockholders, is a violation of the rights of those stockholders, and a Court of Equity will restrain the company from such an act.

NOTE. — *People* v. *Chicago Gas Trust Co.*, 130 Ill. 268. A corporation formed under a general law for the manufacture and sale of gas cannot clothe itself with power to purchase and hold stock in similar corporations by naming this as one of its objects in the articles filed with the Secretary of State. See also *People* v. *Union Gas Co.*, 254 Ill. 395.

Dunbar v. *American Telephone Co.*, 224 Ill. 9. A domestic telephone company would not have had power to purchase a majority of the stock of a corporation, organized to manufacture and sell electric telephone and telegraph instruments, for the purpose of control; a foreign telephone company therefore has no power to make such a purchase in Illinois; and a purchase by trustees for the foreign corporation is as objectionable as a purchase by the foreign corporation itself. See same case, 238 Ill. 456.

Elkins v. *Camden R.R. Co.*, 36 N.J. Eq. 5. It is *ultra vires* for a railroad to purchase a majority of the stock of a rival railroad.

Pearson v. *Concord Railroad*, 62 N.H. 537. It is *ultra vires* for a railroad to purchase stock in another railroad for the purpose of control.

Marble Co. v. *Harvey*, 92 Tenn. 115. A corporation engaged in the marble business has no power to purchase stock of another marble company, for the purpose of control.

See also *Louisville & Nashville R.R. Co.* v. *Kentucky*, 161 U.S. 677, 698; *De la Vergne Co.* v. *German Savings Institution*, 175 U.S. 40, 51.

In *Attorney-General* v. *New York, New Haven, & Hartford R.R. Co.*, 198 Mass. 413, there was an express statutory provision that a railroad corporation should not (with specified exceptions) directly or indirectly subscribe for, take or hold the stock of any other corporation.

CALIFORNIA BANK *v.* KENNEDY.

167 U.S. 362. 1897.

ONE question presented was whether a national bank has power to own the stock of a savings bank.

MR. JUSTICE WHITE. It is settled that the United States statutes relative to national banks constitute the measure of the authority of such corporations, and that they cannot rightfully exercise any powers except those expressly granted, or which are incidental to carrying on the business for which they are established. *Logan County Bank* v. *Townsend*, 139 U.S. 67, 73. No express power to acquire the stock of another corporation is conferred upon a national bank, but it has been held that, as incidental to the power to loan money on personal security, a bank may in the usual course of doing such business accept stock of another corporation as collateral, and by the enforcement of its rights as pledgee it may become the owner of the collateral and be subject to liability as other stockholders. *National Bank* v. *Case*, 99 U.S. 628. So, also, a national bank may be conceded to possess the incidental power of accepting in good faith stock of another corporation as security for a previous indebtedness. It is clear, however, that a national bank does not possess the power to deal in stocks. The prohibition is implied from the failure to grant the power. *First National Bank* v. *National Exchange Bank*, 92 U.S. 122, 128.

On behalf of the plaintiff below it was admitted at the trial that the stock of the savings bank was not "taken as security or anything of the kind," and it is not disputed in the argument at bar that the transaction by which this stock was placed in the name of the bank was one not in the course of the business of banking for which the bank was organized.

NOTE. — A national bank has no power to own the stock of another national bank. *Concord Bank* v. *Hawkins*, 174 U.S. 364. Or of a mercantile corporation. *Metropolitan Stock Exchange* v. *Lyndonville Bank*, 76 Vt. 303.

If a corporation has power to lend money, it has power to take stock of other corporations as security. *Calumet Paper Co.* v. *Stotts Investment Co.*, 96 Iowa, 147; *Baldwin* v. *Canfield*, 26 Minn. 43; *Westminster Bank* v. *Electrical Works*, 73 N.H. 465; *In re Asiatic Banking Corporation*, L.R. 4 Ch. App. 252. Cf. *Franklin Bank* v. *Commercial Bank*, 36 Ohio, 350 (restrictive provision in act under which the banking corporation was organized).

JOINT STOCK DISCOUNT CO. *v.* BROWN.

L.R. 3 Eq. 139. 1866.

The memorandum relative to the incorporation of the Joint Stock Discount Company stated certain specific objects for which the company was established, including the discounting of bills and notes; and then added: "and the doing of all such things as the directors shall consider incidental or conducive to the attainment of the above objects." The directors invested funds of the company in the shares of a new banking company.

Page Wood, V.C. [After holding that such an investment did not come within the objects specifically stated in the memorandum].

Then as regards the second branch of the argument, which is this: that assuming this not to be within the clause for making advances and investing in securities, the directors are to do "all such things as they shall consider incidental or conducive to the attainment of the above objects" — it appears to me to be much too wide a construction of that clause to say, that if the transaction in question is not within the scope of the original terms there stated, it can be brought within the scope of doing that which is considered to be incidental to the attainment of the objects, the objects being to use money, by making it available in the shape of a return of interest, or of discount. How do they justify it in this resolution? They say, if we take all these shares in the bank, it will increase our connections. What a prodigious extension I must give to those words in order to bring it within the power of the directors to do anything which they may consider conducive to the interests of the company by increasing its connections, however unconnected with the objects stated! I apprehend those powers must be exercised only for the purpose of doing something *bonâ fide* connected with the objects to be attained, and in the ordinary course of business adapted to their attainment. This was the only ground on which I proceeded in the case of *Taunton* v. *Royal Insurance Company*, 2 H. & M. 135. There I found that the transaction impeached was in the ordinary course of business, and in the way in which other people conducted their business. In that case, if a large amount of advertisement, or of expenditure of money, had been found necessary, it would have been laid out properly; but to carry the principle on to any remote extension of the objects, on the ground that if shares were bought in this bank there would be some control over the business of the discounting, would be, I apprehend, wholly unwarranted by the plainest rules of construction, which must limit the company's powers to those transactions which are naturally conducive to the objects specified. If the principle were thus extended, it would apply to the buying shares in every sort of undertaking — a brewery, for instance, or any other

business where discounts might be of use. The company might become ship-builders, or might be engaged in any other business; they might buy a share in any general merchant's business, because there would be bills in that business which would want discounting, and so they might get more business.

Perhaps the case of *Simpson* v. *Westminster Hotel Company*, 8 H.L.C. 712, which was taken to the House of Lords, may be considered a strong application of the principle as to the extension of a company's powers. But that case proceeded on this ground, that the company did *bonâ fide* intend to use the building as an hotel, but they said: "One of the greatest expenses of our hotel is the furnishing of it. With our capital we have not the means of furnishing the whole building, but we have the means of furnishing it in part, and of thus starting it directly. Our only alternative, consequently, is either to leave the building which we have erected wholly unproductive, or to let it until we have got such a fund as will enable us to complete the furnishing." Therefore it was let, and that the letting was not so very far from the objects of the company was shewn by this, that they inserted a stipulation for furnishing luncheons to the different clerks in the office. Everything tended to shew extreme *bona fides* in making use of that as a clear and definite means of getting at their object, and as the only means they had of making the hotel available, because it came to the alternative of leaving the property wholly unproductive, or of getting £5000 a-year for it, with the additional chance of supplying a certain amount of eating and drinking on the premises.

In this case the proceeding is simply an embarking in a totally different business; it is not the buying shares for the purpose of selling them again, or for investment, or anything of that kind, but it is buying shares for the purpose of enlarging the particular business which the company have to conduct. I think that it is clear that the bill must be answered, and the demurrer must be overruled, with costs.

Note. — See, *accord*, *New Orleans Steamship Co.* v. *Ocean Dry Dock Co.*, 28 La. Ann. 173; *Railway Co.* v. *Iron Co.*, 46 Ohio, 44; *McCampbell* v. *Fountain Head R.R. Co.*, 111 Tenn. 55.

PEOPLE *v.* PULLMAN CAR CO.

175 Ill. 125. 1898.

Section 4 of the act in corporating the Pullman Car Co. was as follows: "The said corporation shall have power to manufacture, construct and purchase railway cars, with all convenient appendages,

and supplies for persons travelling therein, and the same may sell or use, or permit to be used, in such manner and upon such terms as the said company may think fit and proper."

MR. JUSTICE BOGGS. The pleas admit the appellee company has purchased and holds a majority of the shares of the capital stock of the Pullman Iron and Steel Company, and avers further that said Pullman Iron and Steel Company was never a competitor in business with defendant; that its products constitute a necessary part of the material required in the construction of the cars manufactured by defendant; that all its product is used and consumed by said defendant, and that the said corporation is, in effect, a mere department of defendant in its car manufacturing business, although existing nominally as an independent corporation. The right and power of a corporation to become a stockholder in another corporation was presented to this court for determination in the case of *People* v. *Chicago Gas Trust Co.*, 130 Ill. 268, and the conclusion arrived at was, that a corporation cannot become a stockholder in another corporation unless power to do so is specifically granted in its charter or necessarily implied from it. The conclusion there announced is the prevailing doctrine in America, and we see no reason to depart from it. Such power is not specifically granted to the appellee corporation, and there is no room for the contention that it is possessed as an implied power. The decision of the circuit court ousting the appellee from the right to hold capital stock in the Pullman Iron and Steel Company was correct, and is affirmed.

STATE *v.* MISSOURI PACIFIC RY. CO.

237 Mo. 338. 1911.

VALLIANT, C.J. The information is in *quo warranto.* The respondents are Missouri corporations; the business for which each was incorporated is indicated by its corporate name, a railroad company, two coal mining companies, and an elevator company.

The charge in the information is that the railroad company has acquired the capital stock of the three other corporations and is engaged in conducting the business for which they were incorporated. More specifically stated, the charge is that the Western Coal & Mining Company was organized under the laws of this State in 1879, with a capital stock of $500,000, for the purpose of carrying on a general coal and mining business in Missouri, Kansas and elsewhere, with power to purchase, lease or otherwise acquire mineral and other lands for the purpose of mining coal and other minerals, buying and selling coal, etc., and owning and operating machinery and appurtenances necessary to carry on that business; and that after its or-

ganization the corporation entered upon the business for which it was chartered and continued to conduct the same until the acquisition of its capital stock by the Missouri Pacific Railway Company, whereupon it ceased to perform its functions and the business has since and is still being conducted alone by the railroad company, to the injury of the interests and welfare of the people of the State.

Like specifications are made in relation to the Rich Hill Coal Mining Company, and, varying only in reference to the character of the business, relating also to the Kansas-Missouri Elevator Company. The conclusion from those facts drawn in the information is that the two coal companies and the elevator company have lost their integrity and individuality and are rendered incapable of exercising the franchises granted by their respective charters, that each had become a mere cover for the unlawful exercise of power by the railroad company, and their further existence is of injury to the people of the State.

The prayer is that the two coal companies and the elevator company be ousted of their charters, that the railroad company be ordered to cease operating the business of those three companies, and failing to heed such order, that it be ousted of the corporate rights granted by its charter.

The respondents filed a joint answer to the following effect: They admit the origination of each of the corporations as stated in the information and the purpose for which it was organized, and they admit that a majority of the capital stock of the three other companies is owned by a trustee who holds the legal title thereto for the use and benefit of the railroad company, but aver that there are four other persons who each own at least one share of the stock. Referring to the averment in the information to the effect that the railroad company holds its charter from the State and has only the powers granted to it as a railroad company by the laws of the State, which are only such powers as are necessary, convenient and incident to the construction, maintenance and operation of a railroad as a public highway, and that under the Constitution it can engage in no business other than that expressly authorized by the charter or the law under which it may have been organized, the answer avers that the railroad company has offended in no respect the provisions of the law referred to and has not gone beyond the lawful power conferred by its charter; that the acquiring of the stock in the coal companies was for the purpose only of securing for its use in operating its railroad the necessary supply of coal for fuel, and the acquiring of the stock in the elevator was to facilitate the shipping and transportation of grain over the railroad. They deny that since the acquisition of the stock by the railroad company the coal companies and the elevator company have ceased to do business under their respective charters or that such business is or has been conducted by the railroad com-

pany; on the contrary, they aver that since the acquisition of the stock, as before, the business of the coal companies and the elevator company have been conducted exclusively by their respective boards of directors duly elected by the stockholders. They deny that there has been any abuse of their charter powers or any conduct on the part of the directors injurious to the interest or welfare of the people of the State, or that the interests or welfare of the people would be promoted by a dissolution of the corporations named or a forfeiture by the railroad company of its beneficial interest in the stock of the other companies.

To that answer the Attorney-General filed a reply in which, after denying that any persons other than the trustee for the railroad company owned any of the stock and denying that the stock was acquired for the purposes stated in the answer, went on to aver that, since the acquisition of the stock in the coal companies, the railroad company "through the management, conduct and control of the said coal companies, engaged in the business of selling coal to the general public and did sell large amounts through and under the name of said coal and mining companies to the general public in Missouri and elsewhere." An averment of like character was made in reference to the business of the elevator company. These averments differ from those in the information in this, to wit: in the information it was stated that the railroad company itself was, under cover of the charters of these other companies, carrying on the business of mining and marketing coal and a general warehouse and elevator business, whereas the averments in the reply are that the railroad company was doing those acts through the management of the coal and elevator companies, by virtue of its ownership of the stock in those companies. On motion of the respondents the court struck out those averments in the reply, construing them to be the pleader's inference from the fact of the ownership of the stock, and since the ownership of the stock was admitted in the answer, or return, the inference to be drawn was but a legal conclusion.

The State then moved for judgment on the pleadings and that is the form in which the cause is now submitted for final judgment.

For the purposes of this motion the statements in the answer (or return) of respondents must be taken as true, and the statements in the information admitted by the answer will also be taken as true; the legal conclusions that either party draws from those facts are open for discussion.

The organization of the corporations as stated in the information, and the several purposes for which they were respectively organized, are admitted, and it is also admitted that the majority of the stock in the coal companies and in the elevator company is held by a trustee for the railroad company.

The language of the answer perhaps justifies the inference also

that all the stock in those companies except four shares in each is held by a trustee for the railroad company, and that those four shares are held by individuals to enable them to qualify as directors as the law requires. Against those admissions we have the statements in the answer that the purpose of the railroad company in acquiring the stock in the coal companies was to secure to itself a supply of coal to be used as fuel in running its trains, and the purpose in acquiring the stock in the elevator company was to facilitate the handling and shipping of grain to be carried over its road; also the statements that the railroad company does not operate or control the operation of either of the coal companies or the elevator company, but on the contrary each is controlled and operated by its own board of directors and officers appointed by the board, and that each company is performing the duties required by its charter and serving the public impartially as the law requires. Those statements must be taken as true with only this qualification, to-wit, the law presumes that the railroad company has exerted its power as a stockholder in electing the directors and to that extent influences the policy of each company.

Under the state of facts above mentioned the only question of law in this case is, may a railroad company own the majority of stock in a coal company adjoining or near its line of road, or in an elevator company offering a convenient means to aid it in the handling and shipping of grain? The question is not, can a railroad company be held to account in a proceeding in *quo warranto* for an abuse of the power which the ownership of a majority of such stock gives? for perhaps no one would doubt that it would be amenable to such an inquiry, but where there has been no abuse of power, where the business of the corporation is being conducted in the usual way of such business concerns, is it unlawful for the railroad company to own the stock?

The only written law to which we are referred as sustaining the contention that it is unlawful for a railroad company to own stock under such conditions is § 7 of article 12 of the Constitution, in which is the following: "No corporation shall engage in business other than that expressly authorized in its charter or the law under which it may have been or hereafter may be organized." That clause in the Constitution does not refer to the ownership of stock in another company; the thing forbidden is the engaging in business not authorized by its charter. It would doubtless be a violation of that clause of the Constitution if a railroad corporation should acquire and use the stock of another corporation in whose business a railroad company could not lawfully engage, as a cover behind which to carry on such business, that is, as a mere means of evading the letter of the law, still, in such case, the offense would be the carrying on of the business, not the owning of the stock.

It would perhaps not be contended that a railroad company could not lawfully own a coal mine and operate it if necessary for the sole purpose of obtaining fuel for its own use, or that it could not own and operate an elevator in the handling of grain to be transported over its railroad. The business therefore of mining coal or operating an elevator is not business of such a character as the clause in the Constitution above quoted forbids. If the railroad company could do that business with its own means, why could it not secure itself in the matter of obtaining coal for fuel or a convenience in handling grain by acquiring stock in a coal or elevator company, if it would be more convenient, and if the public was not injured thereby? The more stock a corporation owns in another concern the more power it has in the election of directors and through them in influencing the policy of the other corporations, but that is not in fact taking the management of the business in its own hands. We are not overlooking the fact that where a corporation owns practically all the stock in another concern it may, if so minded, dictate through the board of directors the method of the business, which would be equivalent to indirectly conducting the business; but that consequence does not necessarily follow; the directors may be chosen with an eye to their ability and honesty and left to conduct the business according to their best judgment, and the law will presume that such is the case until the contrary is shown; if it should be shown that directors are conducting the business in the interest alone of a stockholder who elected them and to the injury of the other stockholders or to that of the public in general, a case of fraudulent mismanagement would appear, calling for the arm of a court of equity; but such is not this case. We therefore conclude that § 7 of article 12 of the Constitution does not forbid a railroad company to own stock in a coal company or an elevator company, and we hold that the mere fact that the railroad company does own a majority or all but a few shares of the stock in those companies, does not authorize a judgment of dissolution of the corporations and ouster of their franchises.

It is charged in the information that the charters of the coal companies and the elevator company have become a mere cover for the railroad company under which to hide its unlawful usurpation of the corporate franchises, that those companies by such unlawful usurpation by the railroad company have been rendered incapable of conducting their business, and that their businesses are being conducted by the railroad company. But those statements are denied in the answer of respondents. It is there stated that the business of each of those companies is and has been from the beginning conducted under the direction and control of its own board of directors. Those statements are to be taken as true and, taking them as true, it leaves the State's case nothing to rest on but the bare fact that the railroad company owns the majority of stock in those other companies.

There is no use for us to go further and decide whether or not a railroad company may lawfully acquire and hold any or all the capital stock of another corporation whose business has no influence in aiding it in operating its railroad, because there is no such question before us. The court will take judicial knowledge of the fact that coal for fuel is a necessity in the operation of a steam railroad and that an elevator, although not an absolute necessity, is an assistance in the handling and shipping of grain, and we hold that a railroad company may acquire stock in coal and elevator companies when the purpose is, as in this case it is, to facilitate the business for which it was chartered.

Our judgment is that the ouster demanded in the information should be denied and the respondents discharged. It is so ordered. All concur, except KENNISH, J., not sitting, having been of counsel.

NOTE. — See also *State* v. *Missouri Pacific Ry. Co.*, 241 Mo. 1.

FIRST NATIONAL BANK *v.* NATIONAL EXCHANGE BANK.

92 U.S. 122. 1875.

ERROR to the Court of Appeals of the State of Maryland.

The plaintiff, a national bank organized under the laws of the United States, and doing business at Charlotte, N.C., desiring to increase its capital stock, and for that purpose to deposit with the treasurer of the United States of Washington $50,000 in bonds of the United States, employed Bayne & Co., of Baltimore, as its agent, to procure and deliver them at the treasury. Not having money to pay for them at the time, the plaintiff sent its president, Wilkes, to Baltimore, with a certificate previously prepared in Charlotte, as follows: —

"FIRST NATIONAL BANK OF CHARLOTTE, N.C.,
"CHARLOTTE, Dec. 15, 1865.

"Received on deposit, from Bayne & Co., fifty-five thousand United States 5-20 bonds, third issue, payable to the order of themselves on return of this certificate.

"JOHN WILKES,
"*Pres. First Nat. Bk., Charlotte, N.C.*"

This certificate was delivered by Wilkes to Bayne & Co. in Baltimore; and on the 18th of December, 1865, they, having indorsed the same, deposited it, together with other securities, with the National Exchange Bank of Baltimore, as collateral security for a call loan of $80,000 then made by that bank to said firm of Bayne & Co.

A few days after the delivery of said certificate, the plaintiff deposited in New York, to the credit of Bayne & Co., a sum sufficient to pay the same, and received, in January, 1866, oral notice from them that the certificate was discharged, and subject to its order. In March, 1866, the plaintiff received a written notice to the same effect, but did not apply for the surrender of said certificate. In April following, Bayne & Co. failed; and the plaintiff was then notified by the defendant that it held the certificate of deposit for value, and demanded the delivery of the bonds therein mentioned.

Wilkes, the president, was sent by the plaintiff to Baltimore to negotiate for the return of said certificate. He informed the defendant that it had been satisfied by the payment to Bayne & Co., and disavowed any legal liability on account of same to the defendant. To avoid suit, however, Wilkes offered to pay $5,000 upon the delivery of the certificate; which defendant refused, but offered to take $20,000, and threatened suit unless so settled. Wilkes declined to pay this sum, but asked for delay until he could return to Charlotte and consult the directors of his bank. He again returned to Baltimore, and new negotiations for compromise of the controversy between the two banks in regard to their respective rights to the certificate were opened. Wilkes ascertained that the defendant held, among its collaterals from Bayne & Co., a large number of shares of Washington, Alexandria, and Georgetown Railroad stocks, the market-value of which had been seriously depressed by the failure of Bayne & Co. Having informed himself in regard to the condition of the stock and its supposed value, and after one or two interviews with the president and directors of the defendant, it was finally agreed that the plaintiff should take four hundred shares of the Washington, Alexandria, and Georgetown Railroad stock, and one thousand shares of the Maryland Anthracite stock, the same being valued at $40,000; and one hundred and twenty-five shares of the stock of the plaintiff, valued at $15,000, — the latter, inasmuch as he was advised that a national bank could not buy its own stock, to be taken by Wilkes himself; thus making $55,000. Upon the basis of this settlement, the defendant was to deliver to Wilkes the certificate held by it for the $55,000 United States bonds. The plaintiff paid to the defendant the sum of $40,000 according to the terms of the above settlement, and received the certificates for one thousand shares coal stock. The four hundred shares of railroad stock were not then delivered, there being a suit about it at the time of the agreement which prevented all transfers; but it was regarded and treated by both parties as belonging to the plaintiff.

In September, 1869, nearly three years after the date of the settlement, suit was brought by the plaintiff in the Superior Court of Baltimore City to recover the $40,000 paid by it to the defendant in

pursuance of the arrangement above stated. At the request of the plaintiff, the court granted the following propositions of law: —

First, That if the plaintiff agreed to purchase for $40,000 the railroad and coal stock, and paid that sum, then the court must find for the plaintiff for that amount; provided the court shall find that the defendant knew the plaintiff to be a national bank, and shall further find that the certificate of deposit was delivered up in consequence of said contract, if by said contract no part of the $40,000 was to be paid for the certificate.

Second, That if the plaintiff agreed to purchase the said stock for $40,000, and Wilkes also agreed to purchase for $15,000 one hundred and twenty-five shares of plaintiff's stock, and the inducement to both agreements was Wilkes's desire to obtain the certificate of deposit, and he did so obtain it, that does not inure to make the first contract valid, provided the court shall find, that, by the first-mentioned contract, the consideration for which the sum of $40,000 was to be paid was the railroad and coal stock, and that no part of said sum was to be paid for the certificate of deposit.

Third, That if the plaintiff, in order to compromise the certificate of deposit, agreed to purchase it and the railroad and coal stock for $40,000, and paid the money, then the plaintiff is entitled to recover so much of said sum as the court shall find was paid for said stock.

The court found for the defendant, and rendered a judgment in its favor, which the Court of Appeals affirmed: whereupon the case was brought here by writ of error.

MR. CHIEF JUSTICE WAITE delivered the opinion of the court.

The question presented for our consideration in this case is, whether a national bank, organized under the National Banking Act, may, in a fair and *bona fide* compromise of a contested claim against it growing out of a legitimate banking transaction, pay a larger sum than would have been exacted in satisfaction of the demand, so as to obtain by the arrangement a transfer of certain stocks in railroad and other corporations; it being honestly believed at the time, that, by turning the stocks into money under more favorable circumstances than then existed, a loss, which would otherwise accrue from the transaction, might be averted or diminished. Such, according to the finding below, was the state of facts out of which this suit has arisen. That finding is conclusive upon us.

A national bank can "exercise by its board of directors, or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking, by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes." Rev. Stat., § 5136, par. 7; 15 Stat. 101, § 8.

Authority is thus given to transact such a banking business as is specified, and all incidental powers necessary to carry it on are granted. These powers are such as are required to meet all the legitimate demands of the authorized business, and to enable a bank to conduct its affairs, within the general scope of its charter, safely and prudently. This necessarily implies the right of a bank to incur liabilities in the regular course of its business, as well as to become the creditor of others. Its own obligations must be met, and debts due to it collected or secured. The power to adopt reasonable and appropriate measures for these purposes is an incident to the power to incur the liability or become the creditor. Obligations may be assumed that result unfortunately. Loans or discounts may be made that cannot be met at maturity. Compromises to avoid or reduce losses are oftentimes the necessary results of this condition of things. These compromises come within the general scope of the powers committed to the board of directors and the officers and agents of the bank, and are submitted to their judgment and discretion, except to the extent that they are restrained by the charter or by-laws. Banks may do, in this behalf, whatever natural persons could do under like circumstances

To some extent, it has been thought expedient in the National Banking Act to limit this power. Thus, as to real estate, it is provided (Rev. Stat., § 5137; 13 Stat. 107, § 28) that it may be accepted in good faith as security for, or in payment of, debts previously contracted; but, if accepted in payment, it must not be retained more than five years. So, while a bank is expressly prohibited (§ 5201; 13 Stat. 110, § 35) from loaning money upon or purchasing its own stock, special authority is given for the acceptance of its shares as security for, and in payment of, debts previously contracted in good faith; but all shares purchased under this power must be again sold or disposed of at private or public sale within six months from the time they are acquired.

Dealing in stocks is not expressly prohibited; but such a prohibition is implied from the failure to grant the power. In the honest exercise of the power to compromise a doubtful debt owing to a bank, it can hardly be doubted that stocks may be accepted in payment and satisfaction, with a view to their subsequent sale or conversion into money so as to make good or reduce an anticipated loss. Such a transaction would not amount to a dealing in stocks. It was, in effect, so decided in *Fleckner* v. *Bank of U.S.*, 8 Wheat. 351, where it was held that a prohibition against trading and dealing was nothing more than a prohibition against engaging in the ordinary business of buying and selling for profit, and did not include purchases resulting from ordinary banking transactions. For this reason, among others, the acceptance of an indorsed note in payment of a debt due was decided not to be a "dealing" in notes. Of course, all such trans-

actions must be compromises in good faith, and not mere cloaks or devices to cover unauthorized practices.

It is difficult to see how a debt due from, or a contested obligation resting upon, a bank, occupies any different position in respect to this power of adjustment and compromise from that of a debt owing to it. The object in both cases is to get rid of or reduce an apprehended loss growing out of legitimate business; and it would seem that whatever might be done in the one case ought not to be excluded from the other under the same circumstances. Often a discharge by a bank of its own obligation creates a debt due to it from another. Such was the case here. Bayne, without authority, transferred to the defendant, as collateral security for his indebtedness, a certificate of deposit issued to him by the plaintiff, and afterwards collected the money due upon the certificate from the plaintiff without disclosing the transfer. Any payment by the plaintiff to the defendant, therefore, in discharge of its liability upon the certificate became a lawful charge against Bayne. He was insolvent. It was, on this account, not only the right, but the duty, of the officers and agents of the plaintiff to protect by their arrangements, as far as possible, the stockholders whose interests they represented. This was necessarily left to their judgment and discretion. No question of good faith is involved. The transaction for all the purposes of this suit must be taken to have been, in fact, what it purports to be, — a fair and honest compromise of an outstanding claim, with a view to ultimate protection against an impending loss. As such, we think it was within the corporate powers of the bank, and that the Court of Appeals did not err in so holding.

Judgment affirmed.

NOTE. — It was held that the corporation in question had power to take stock in other corporations in payment of a previously existing debt in *Morgan* v. *King*, 27 Colo. 539; *Latimer* v. *State Bank*, 102 Iowa, 162; *Deposit Bank* v. *Barrett*, 13 S.W. (Ky.) 337; *Hill* v. *Shilling*, 69 Neb. 152; *Howe* v. *Boston Carpet Co.*, 16 Gray (Mass.) 493; *Holmes Mfg. Co.* v. *Holmes Metal Co.*, 127 N.Y. 252, 259.

But see *First National Bank* v. *Converse*, 200 U.S. 425. A manufacturing corporation became insolvent. A National Bank was among its creditors. The creditors organized a new corporation with power to purchase the capital stock of the old corporation, evidences of indebtedness issued by it, and its assets, and with power to manufacture and sell specified articles. The bank took stock in this new corporation in payment of its debt, and a majority of the court was of opinion that this was *ultra vires*. Mr. Justice WHITE said that the new corporation "was organized to embark in the purely speculative business of buying and selling the stock and assets of an existing and insolvent corporation, with power, but without

the obligation, to engage as an independent enterprise in a manufacturing business. . . . As no authority, express or implied, has ever been conferred by the statutes of the United States upon a national bank to engage in or promote a purely speculative business or adventure, . . . it follows that the bank had no power to engage in such business by taking stock or otherwise. The power of a national bank to engage in the character of business which the articles of association of the thresher company manifested, as defined by the Supreme Court of Minnesota, cannot be inferred to have been possessed by the bank as an incident of securing a present loan of money or as a means of protecting itself from loss upon a preëxisting indebtedness. To concede that a national bank has ordinarily the right to take stock in another corporation as collateral for a present loan or as security for a preëxisting debt, does not imply that because a national bank has lent money to a corporation it may become an organizer and take stock in a new and speculative venture; in other words, do the very thing which the previous decisions of this court have held cannot be done."

As to the power of a corporation to sell property for stock in another corporation, with intent to resell the stock, see *White* v. *Marquardt*, 105 Iowa, 145; *Hodges* v. *N.E. Screw Co.*, 1 R.I. 312, 347. *Cf. Railway Co.* v. *Iron Co.*, 46 Ohio, 44.

In *Hodges* v. *N.E. Screw Co.*, 1 R.I. 312, the court said (p. 347): "There are large classes of corporations in Rhode Island and the other States, which may and do rightfully invest their capital in the stock of other corporations; such, for instance, as religious and charitable corporations, and corporations for literary and scientific purposes. So insurance companies may rightfully invest their capital in the stock of other corporations, such as banks and railroads, and the like." But in *Commercial Insurance Co.* v. *Board of Revenue*, 99 Ala. 1, it was held that an insurance company has no power to invest in the stock of a bank.

In *Burland* v. *Earle* [1902], A.C. 83, 95, it was held that the company in question had power to invest its surplus in shares in other companies. There is some American authority in accord. In *Booth* v. *Robinson*, 55 Md. 419, the court said (p. 433): "Having money to loan or invest, there would appear to be no good reason why it might not invest in the stock of other corporations as well as in any other funds, provided it be done *bona fide*, and with no sinister or unlawful purpose." And see *Layng* v. *French Spring Co., Ltd.*, 149 Pa. 308.

HILL *v.* NISBET.

100 Ind. 341. 1884.

One question presented was whether the purchase of stock of the Cincinnati, Rockport and Southwestern Railway Company by the Evansville Local Trade Railroad Company was *ultra vires*.

Mitchell, J. The Evansville Local Trade Railroad Company was organized under the general statute of the State for the organization of railroads, with the purpose in view of constructing a railroad from the city of Evansville to some point of connection with, or intersection of, the Cincinnati, Rockport and Southwestern Railway, and from the whole record it may be gathered that it was within the object of the organization to become ultimately consolidated with the latter company. The general purpose being to promote the commercial interests of the city of Evansville, and to create a railroad corporation whose business would prove remunerative to its stockholders.

As, under the statutes of the State, railroad corporations may be organized, and after organization they may acquire by purchase, or consolidate with, other connecting or intersecting lines, it can not be said that the organization of a railroad corporation, with a view of ultimately becoming consolidated, upon equitable terms and in accordance with the provisions of the statute, with one already existing, is against public policy.

At the time of the purchase of the stock in question the Local Trade Railroad Company was in its incipiency, not having progressed farther, perhaps, than a paper organization, and the subscription of $70,750 to its stock.

It does not appear whether its line had been located or not, but if this was done it seems to be granted that no further progress had been made. It seems to be conceded on all hands, too, that the accomplishment of the end had in view by its projectors would be greatly facilitated by the acquisition by it of a controlling interest in the Cincinnati, etc., Co., with the ultimate purpose in view of consolidating the two properties, thereby making one of more value to the stockholders and of more efficiency for public good.

The proposition is stated broadly in many cases, that one corporation can not, without express statutory authority, become the owner of any portion of the stock of another corporation. *Pearce* v. *Madison, etc., R. R. Co.*, 21 How. 441; *Mutual Savings Bank, etc., Ass'n* v. *Meridian Agency Co.*, 24 Conn. 159; *Franklin Co.* v. *Lewiston Savings Bank*, 68 Maine, 43; *Central Railroad Co.* v. *Collins*, 40 Ga. 582; *Sumner* v. *Marcy*, 3 Wood. & M. 105; *Franklin Bank* v. *Commercial Bank*, 36 Ohio St. 350 (38 Am. R. 594).

It is said that if this were not so, a banking corporation could

become the operator of a railroad, or a railroad corporation might engage in the banking business. It must be said at once, that where the purchase of stock in one corporation by another amounts to engaging in a business other than that authorized by its charter, such purchase is *ultra vires,* and this is so, not because the purchase is stock, but because the business is outside the scope of its charter.

Whether the purchase of stock in one corporation by another is *ultra vires* or not, must depend upon the purpose for which the purchase was made, and whether such purchase was, under all the circumstances, a necessary or reasonable means of carrying out the object for which the corporation was created, or one which under the statute it might accomplish.

§ 3951, R.S. 1881, authorizes any railroad corporation organized under the provisions of the general railroad law, "to acquire, by purchase or contract, the road, road-bed, real and personal property, rights and franchises of any other railroad corporation or corporations which may cross or intersect" its line; and if in any case it should appear to be a necessary or reasonable means to that end, no reason is perceived why it might not be accomplished by purchasing the stock, instead of purchasing the corporate property directly. In short, the purchase of stock by one railroad corporation in another will be upheld whenever it is a necessary or reasonable means to the accomplishment of an end proposed, which is within the scope of its statutory powers.

Keeping in view the averments in the complaint, from which the purpose for which the stock was purchased may be fairly inferred, and considering the broad and comprehensive powers conferred by the statutes on railroad corporations, authorizing them to acquire real and personal property "necessary to accomplish the objects for which the corporation is created," and to acquire the property of, and consolidate with uncompleted connecting and intersecting lines, we can not say that the purchase of the stock was unauthorized. R.S. 1881, §§ 3903, 3951.

NOTE. — For other cases where the legislative enactments on the power of corporations to hold stock in other corporations have been liberal, see *Atchison, Topeka & Santa Fé R.R. Co.* v. *Fletcher*, 35 Kan. 236; *Baltimore* v. *Baltimore & Ohio R.R. Co.*, 21 Md. 50; *Dewey* v. *Toledo, Ann Arbor & North Michigan Ry. Co.*, 91 Mich. 351; *MacGinniss* v. *Boston & Montana Mining Co.*, 29 Mont. 428; *Dittman* v. *Distilling Company of America*, 64 N.J. Eq. 537; *Clark* v. *Memphis Street Ry. Co.*, 123 Tenn. 232; *State* v. *Superior Court*, 56 Wash. 214.

STATE *v.* ATLANTIC CITY AND SHORE R.R. CO.

77 N.J.L. 465. 1909.

THE Atlantic City and Shore Railroad Company was authorized under the revised "Act concerning Railroads" (Pamph. L. 1903, p. 645) to build and operate a railroad from Egg Harbor to a point in Atlantic City. It acquired all the stock of the Central Passenger Railway Company (excepting a few qualifying shares of stock necessary to preserve the organization), a street railroad corporation. The tracks of the two corporations met, and the first corporation intended that its passengers should be transported over the tracks of the second corporation.

The State contended that the Atlantic City and Shore Railroad Company had no power to own the stock of the Central Passenger Railway Company.

PITNEY, CHANCELLOR. The Supreme Court entertained the view that irrespective of the powers conferred upon railroad companies by § 3 of the revised act concerning railroads (Pamph. L. 1903, p. 647), the legislature, by the fifty-first section of the General Corporation Act (Pamph. L. 1896, p. 294), has conferred upon every corporation of this State, no matter under what law it may have been organized, the right to acquire and hold the stock and bonds of any other corporation of this or any other State; and that the statute puts no limitation upon the quantity of stock or bonds that may be acquired, so long as one corporation does not acquire all of the stock of another and thus destroy its organization and power to exercise its franchise. It was therefore held that the act of the Shore company in purchasing and holding a controlling interest in the stock of the Central company was within the power conferred upon the Shore company by the legislature.

§ 51 of the General Corporation Act (Pamph. L. 1896, p. 294) reads as follows:

"Any corporation may purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of the shares of the capital stock of, or any bonds, securities or evidences of indebtedness created by any other corporation or corporations of this or any other State, and while owner of such stock may exercise all the rights, powers and privileges of ownership, including the right to vote thereon."

Reading this section alone, and treating it as unqualified by other legislation, it no doubt conveys the very broad import that is attributed to it in the opinion of the Supreme Court. And the circumstance, pointed out in the opinion, that in the year 1893 the legislature by a supplement to the General Corporation Act of 1875 (Pamph. L. 1893, p. 301; Gen. Stat., p. 963, pl. 260) authorized corporations *created under the act of 1875* to purchase, hold, etc.,

shares of the capital stock of any other corporation created under the laws of this or any other State; and that in the revision of 1896 the express limitation of this authority to companies organized under the General Corporation Act was omitted, is no doubt an added reason, beyond the mere language of the present § 51, for giving a somewhat extensive signification to that language.

Nevertheless, upon mature reflection, it seems to us that § 51, when read (as it must be) in the light of what is elsewhere contained in the act of which it is a part, and of the general policy of our corporation laws manifested in numerous other statutes, including the General Railroad Act of 1903, is very much more limited in its effect.

Manifestly, we should first refer to the act under which the railroad company was incorporated. Had this been a special act of legislation it would naturally have contained within itself not only a grant of powers but a limitation, express or implied, upon such grant. But since the constitutional amendments of 1875 forbidding the legislature thereafter to pass special laws granting the right to lay down railroad tracks, or any special act conferring corporate powers, and requiring that general laws be passed under which corporations may be organized and corporate powers of every nature obtained (N.J. Const., art. 4, § 7, pl. 11), the grant of corporate powers is now to be sought in the general laws thus enacted and in the articles of association filed thereunder, which are in effect the "charter" of the company.

The revised "Act concerning Railroads" (Pamph. L. 1903, p. 645), in its first section requires, as the first act to be done by those who assume corporate powers thereunder, that a certificate of incorporation shall be executed, proved or acknowledged as required for deeds of real estate, and filed in the office of the secretary of state, which shall set forth sundry matters requisite for a proper definition and limitation of the powers of the corporation; amongst other things, "the object of the company, the terminal points of the proposed railroad, the counties of this state in or through which it and its branches are intended to be constructed, and the length of such road and each of its branches, as near as may be."

§ 3 of the same act declares that every railroad company shall have the general powers conferred by the Corporation Act of 1896 and the supplements thereto, and shall be governed by the provisions and be subject to the restrictions and liabilities in said act contained, "*so far as the same are appropriate to and not inconsistent with this act or with the provisions of the act under which any such company may have been created and organized,*" and in addition thereto shall have power to locate and determine its route and works, to acquire from time to time and hold and use all such real estate and other property as may in the judgment of its directors be necessary for terminal purposes and for the construction and maintenance of its railroad,

and stations, branches, sidings, car yards, engine houses, repair shops, and other accommodations necessary to accomplish the objects of its incorporation, and to construct and operate its road, to charge and collect fares, etc., and to exercise all other powers by this act granted. § 7 provides that when the route of the railroad shall have been determined upon, a survey of such route and location, particularly describing the same, shall be filed in the office of the secretary of state. Subsequent sections provide for the construction of the proposed railroad and for its maintenance, operation and regulation.

Concerning the Atlantic City and Shore Railroad Company, the record before us discloses that under its charter and according to its route filed in the office of the secretary of state it is authorized to build and has built a line of railway from a point in Egg Harbor township to a point at the corner of Virginia and Adriatic avenues in Atlantic City. These points, therefore, are the *termini* adopted by the company and publicly manifested in the mode prescribed by the Railroad Act. It is plain, we think, that this company is by its articles of association and the provisions of the Railroad Act excluded from building or operating a railroad beyond the *termini* thus specified, either by direct means or by the indirect method of stock ownership in another company, unless, indeed, such power is to be derived from § 3 of the Railroad Act, which confers upon every railroad company certain general powers conferred by the Corporation Act of 1896 and the supplements thereto. But this grant is expressly limited so as to have effect only so far as said powers are "appropriate to and not inconsistent with this act or with the provisions of the act under which any such company may have been created and organized."

The proper construction of this enactment, as we think, is, that since the Railroad Act prescribes definite *termini* for the railroads authorized to be constructed thereunder, and requires these to be stated in the articles of association, powers that are not appropriate to and consistent with the construction, maintenance and operation of a railroad between such *termini* may not be claimed by the railroad company under the section referred to.

Moreover, the grant of general powers contained in that section is confined to such as are conferred by the Corporation Act of 1896. (Pamph. L. 1896, p. 277.) If this act contains in itself any limitation upon the grant of the stockholding power set forth in its fifty-first section, this limitation is of course operative upon railroad companies assuming the power to hold stock in other corporations.

Turning, therefore, to the Act of 1896, we find its first section sets forth certain powers that every corporation shall have, viz., to have succession for the period limited in its charter or certificate of incorporation, and when no period is limited then perpetually; to

sue and be sued; to make and use a common seal; to hold, purchase and convey such real and personal estate as the purposes of the corporation shall require; to appoint officers and agents such as the business of the corporation shall require; to make by-laws; to wind up and dissolve itself or be wound up and dissolved.

§ 2 reads as follows: "In addition to the powers enumerated in the first section of this act, and the powers specified in its charter or in the act or certificate under which it was incorporated, every corporation, its officers, directors and stockholders, shall possess and exercise all the powers and privileges contained in this act *so far as the same are necessary or convenient to the attainment of the objects set forth in such charter or certificate of incorporation*, and shall be governed by the provisions and be subject to all the restrictions and liabilities in this act contained so far as the same are appropriate to and not inconsistent with such charter or the act under which such corporation was formed; *and no corporation shall possess or exercise any other corporate powers except such incidental powers as shall be necessary to the exercise of the powers so given.*"

In the former General Corporation Act, approved April 7th, 1875 (Gen. Stat., p. 907, etc.), § 3 was as follows: "That in addition to the powers enumerated in the first section of this act and to those expressly given in its charter or in the act or certificate under which it is or shall be incorporated, no corporation shall possess or exercise any corporate powers except such as shall be necessary to the exercise of the powers so enumerated and given."

A similar provision contained in the Corporation Act of 1846 was referred to by this court in *Morris and Essex Railroad Co.* v. *Sussex Railroad Co.*, 5 C.E. Gr. 542, 562, where it was pointed out that the common law rule limits corporations to such powers as are given by the charter or necessarily implied for carrying into effect the objects and powers expressly sanctioned.

In the Act of 1896, it will be observed that § 2 combines with the prohibition of corporate powers other than such as are incidental and necessary to the exercise of the granted powers, a liberty to exercise all the powers and privileges contained in this act (only) "so far as the same are necessary or convenient to the attainment of the objects set forth in such charter or certificate of incorporation." But this language itself imports a grant merely incidental to the declared objects of the company.

Among the powers and privileges referred to are those mentioned in § 51 of the same act with respect to purchasing and holding shares of the stock and bonds and other evidences of indebtedness of other corporations. We deem it clear that § 51 is to be construed in subordination to § 2, and that the State thereby grants to one corporation the capacity to hold stock in another corporation only so far as such stock ownership is necessary or convenient to the attainment

of the objects set forth in the charter or certificate of incorporation of the holding company.

Not only does this construction result, as we think, from the letter of the law, but it seems to us that to read § 51 as unqualified by anything *ab extra* would contravene the general policy of our corporation laws.

Our Corporation Act and Railroad Act are not exceptional in requiring that the objects of the proposed company shall be stated in the certificate of incorporation, and that this certificate shall be made a matter of public record. Numerous other acts providing for the incorporation of different kinds of companies contain similar provisions. The legislative purpose is to preserve, for the benefit of the people and of private parties concerned, solemn evidence of the corporate powers that have been granted, of the contract made between the State and the corporations, and of the contract made by the corporators *inter sese.* It is only by reference to the certificates of incorporation that the attorney-general and other officials interested in behalf of the State can readily determine what powers have been granted and what have not been granted, and whether the company is usurping franchises not granted by the State. It is by reference to the articles of association that investors can conveniently ascertain the character of the contract into which they are entering and the property rights they are acquiring by purchasing stock of the company. And while the present proceeding raises no question of the rights of dissenting stockholders, the interests of stockholders and investors are not to be laid aside when we are inquiring what construction is to be placed upon the statutory provisions in question.

It will be seen upon a little reflection that if the language of § 51 of the General Corporation Act had unlimited scope, the articles of association would afford the least possible indication of the real objects of the company, and no evidence whatever of any limitation upon the powers that might in fact be exercised. Indeed, there would be practically no limitation.

For it must not be forgotten that stock ownership by one company in another is only a mode by which the former company engages in the business of the latter. Whether the stock ownership be large or small, it amounts in effect to a participation in the business for which the second company is formed. But since the second company (if § 51 were unqualified in its effect) might likewise hold stock in any other corporation or corporations, and these might do the same *ad infinitum,* stock ownership in any company under such a system would not evidence a participation in any definite kind of business, but in effect a participation in a "blind pool," subject to the uncontrolled will of the majority. There would be an end at once of all practical force of the doctrine that a certificate of incorpora-

tion evidences a contract between the State and the corporation, or between the corporators or stockholders themselves. For an agreement imports an obligation to do some things and to refrain from doing other things. Without defining terms and bounds there can be no agreement.

Thus, if the Atlantic City and Shore Railroad Company, upon becoming incorporated for the avowed purpose of constructing and operating a specified line of railroad, and without regard to whether the purchase of stock in other companies is necessary or convenient to the attainment of the objects set forth in its certificate, has the unlimited power to purchase stock and bonds of any other corporation or corporations of this or any other State, it may purchase not only the stock of a traction company in Atlantic City, but the stock of a mining company in Colorado, or may participate in like manner in any conceivable business or speculation in any part of the civilized world. Its articles of association would afford no evidence, either to the law officer of the State or to intending purchasers of its shares, as to the actual scope of its activities; nor would any investor have the slightest assurance that the money he intended to embark in a railroad enterprise in Atlantic county, or the earnings of the capital already embarked, would not be diverted into schemes that he had no means of foreseeing.

Again, § 6 of the Corporation Act of 1896 (Pamph. L. 1896, p. 279; amended before incorporation of the Shore Company by Pamph. L. 1899, p. 473), undertakes to prescribe the objects for which corporations may be formed under that act, and these include almost any lawful purpose whatever, *other than* the formation of a savings bank, a building and loan association, an insurance company, a surety company, or a company operating railroads, telephone or telegraph lines within this State.

It has, indeed, been repeatedly held that where the legislature passes separate acts providing for the organization of certain classes of corporations (especially those owing duties and responsibilities to the public) under conditions inconsistent with or different from those prescribed by the General Corporation Act, the effect is to impliedly prohibit the organization of corporations of those classes under the latter act, although there be no express prohibition in terms. See *Domestic Telegraph Co.* v. *Newark*, 20 Vroom, 344, 348; *Richards* v. *Dover*, 32 *Id.* 400, 403; *Montclair Military Academy* v. *Assessors*, 36 *Id.* 516; *Fogg* v. *Ocean City*, 45 *Id.* 362, 366; *Knickerbocker Importation Co.* v. *Board of Assessors*, *Id.* 583, 590. So far as observed, this doctrine has not heretofore been directly in question in this court, and we do not at present propose to pass upon its soundness, or its precise limitations if sound.

But it is worthy of remark that if § 51 of the Act of 1896 has the unlimited scope that a reading of that section alone would indicate,

then a company may be organized under that act, and, without expressing any such purpose in its articles of association, may in effect conduct banks and other financial institutions, or operate railroads, telegraph lines, and other public utilities in this State, by employing the device of acquiring a controlling interest in companies having such activities.

Again, it is undoubtedly the general rule in this country that one corporation may not become a stockholder in another unless authority is clearly granted by statute; and this is but a corollary of the principle that corporations possess only such powers as are specifically granted by the State, and such incidental powers as are necessary for carrying these into effect. *Franklin Company* v. *Lewiston Institution for Savings*, 68 Me. 43; 28 Am. Rep. 9, and note, p. 15; 1 Thomp. Corp., § 1102; 4 *Id.*, § 5719.

To read § 51 of the Corporation Act as conferring upon every company, as a primary power, the capacity of holding stock in other corporations, without the mention of such an object among the declared purposes of the company, and without regard to whether such stockholding is necessary or appropriate to the objects that are declared, would result in such an overthrow of these established rules and general principles and of the general statutory policy referred to, and would lead to such confusion and such destruction of proper safeguards, that we are constrained to reject that reading in the absence of language imperatively requiring it.

On the other hand, to treat § 51 (as we do) as designed to express and define one of those powers that are referred to in § 2 of the same act, which may be claimed as a primary power when the purpose to exercise it as such is expressed in the certificate of incorporation, and which otherwise may be claimed only as an incidental power, extending so far as may be necessary or convenient to the objects of the company that are expressed in the certificate of incorporation, renders § 51 consistent not only with § 2, but with the general legislative policy of the State respecting corporations.

It will be observed, therefore, that while the legislature, upon placing the provisions that were in Pamph. L. 1893, p. 301 (Gen. Stat., p. 963, pl. 260) into the revised Act of 1896, eliminated the words that confined their operation to corporations created under the Act of 1875, they at the same time, as we think, embodied a more practical and useful limitation by the language employed in § 2 of the new act.

We incline to think the view we entertain of the proper scope and operation of § 51 is the same that is held by the legal profession in general. The articles of association of what are known as "holding companies" usually, we believe, are made to express in terms the purpose of holding stocks in other corporations. This is true, at least, of notable examples that have come before this court in litigation.

As already remarked, the incidental powers of railroad companies organized under the act of 1903 (Pamph. L., p. 645), is likewise limited by the language of the third section so as to extend only so far as appropriate to and not inconsistent with this act; which means, in effect, not inconsistent with the objects of the railroad company as declared pursuant to the provisions of this act.

The result is that the Atlantic City and Shore Railroad Company has not the power to purchase or hold stock or bonds in any other company except so far as may be appropriate, necessary or convenient to the attainment of the objects set forth in its certificate of incorporation and its route filed under the provisions of the Railroad Act, that is to say, the construction, maintenance and operation of a line of railway from a point on the meadows in the township of Egg Harbor to a point at the corner of Virginia and Adriatic avenues in Atlantic City. The fact that the street railway lines of the Central Company are beyond those *termini* is sufficient, of itself, to show that a control of its securities is beyond the legitimate functions of the Shore Company.

Let the judgment of the Supreme Court be reversed.

For affirmance — MINTURN, GRAY, DILL, JJ. 3.

For reversal — THE CHANCELLOR, GARRISON, SAWYZE, REED, TRENCHARD, PARKER, VOORHEES, BOGERT, VREDENBURGH, JJ. 9.

NOTE. — See also *Robatham* v. *Prudential Insurance Co.*, 64 N.J. Eq. 673.

Even if a corporation has power to purchase stock in another corporation, such a purchase may be objectionable on some ground other than that it is *ultra vires*. See *United States* v. *Union Pacific R.R. Co.*, 226 U.S. 61, *infra*.

SECTION 4.

TO HOLD THEIR OWN STOCK.

TREVOR *v.* WHITWORTH.

L.R. 12 A.C. 409. 1887.

Appeal from a decision of the Court of Appeal.

James Schofield & Sons Limited were incorporated in 1865 under the Companies Act 1862 with a capital of £150,000 in 15,000 shares of £10 each. The objects, as stated in the memorandum of association, were to acquire and carry on the business of certain flannel manufacturers, and any other businesses and transactions which the company might consider to be in any way conducive or auxiliary thereto, or proper to be carried on in connection therewith.

The memorandum did not authorize the company to purchase its own shares; but the articles of association purported to authorize such purchases.

The company having, in 1884, gone into liquidation, a claim was made against the company by the respondents, as executors of Whitworth, a deceased shareholder, for the balance of the price of Whitworth's shares sold by the executors to the company in 1880, and not wholly paid for.

The Vice Chancellor of the County Palatine of Lancaster disallowed the claim.

The Court of Appeal (Cotton, Bowen and Fry, L.JJ.) reversed this decision and allowed the claim. Against this last decision the official liquidators now appealed.

Lord Herschell. I pass now to the main question in this case, which is one of great and general importance, whether the company had power to purchase the shares. The result of the judgment in the Court below is certainly somewhat startling. The creditors of the company which is being wound up, who have a right to look to the paid-up capital as the fund out of which their debts are to be discharged, find coming into competition with them persons who, in respect only of their having been, and having ceased to be, shareholders in the company, claim that the company shall pay to them a part of that capital. The memorandum of association, it is admitted, does not authorize the purchase by the company of its own shares. It states, as the objects for which the company is established, the acquiring certain manufacturing businesses and the undertaking and carrying on the businesses so acquired, and any other business

and transaction which the company consider to be in any way auxiliary thereto, or proper to be carried on in connection therewith.

It cannot be questioned, since the case of *Ashbury Railway Carriage and Iron Company* v. *Riche*, Law Rep. 7 H.L. 653, that a company cannot employ its funds for the purpose of any transactions which do not come within the objects specified in the memorandum, and that a company cannot by its articles of association extend its power in this respect. These propositions are not and could not be impeached in the judgments of the Court of Appeal, but it is said to be settled by authority, that although a company could not, under such a memorandum as the present, by articles authorize a trafficking in its own shares, it might authorize the board to buy its shares "whenever they thought it desirable for the purposes of the company," or "in cases where it was incidental to the legitimate objects of the company that it should do so." The former is Lord Justice COTTON's expression; the latter that of Lord Justice BOWEN.

I will first consider the question apart from authority, and then examine the decisions relied on.

The Companies Act 1862 requires (§ 8) that in the case of a company where the liability of the shareholders is limited, the memorandum shall contain the amount of the capital with which the company proposes to be registered, divided into shares of a certain fixed amount; and provides (§ 12) that such a company may increase its capital and divide it into shares of larger amount than the existing shares, or convert its paid-up shares into stock, but that "save as aforesaid, no alteration shall be made by any company in the conditions contained in its memorandum of association."

What is the meaning of the distinction thus drawn between a company without limit on the liability of its members and a company where the liability is limited, but, in the latter case, to assure to those dealing with the company that the whole of the subscribed capital, unless diminished by expenditure upon the objects defined by the memorandum, shall remain available for the discharge of its liabilities? The capital may, no doubt, be diminished by expenditure upon and reasonably incidental to all the objects specified. A part of it may be lost in carrying on the business operations authorized. Of this all persons trusting the company are aware, and take the risk. But I think they have a right to rely, and were intended by the Legislature to have a right to rely, on the capital remaining undiminished by any expenditure outside these limits, or by the return of any part of it to the shareholders.

Experience appears to have shewn that circumstances might occur in which a reduction of the capital would be expedient. Accordingly, by the Act of 1867 provision was made enabling a company under strictly defined conditions to reduce its capital. Nothing can be stronger than these carefully-worded provisions to shew how incon-

sistent with the very constitution of a joint-stock company, with limited liability, the right to reduce its capital was considered to be.

Let me now invite your Lordships' attention to the facts of the present case. The company had purchased, prior to the date of the liquidation, no less than 4142 of its own shares; that is to say, considerably more than a fourth of the paid-up capital of the company had been either paid, or contracted to be paid, to shareholders, in consideration only of their ceasing to be so. I am quite unable to see how this expenditure was incurred in respect of or as incidental to any of the objects specified in the memorandum. And, if not, I have a difficulty in seeing how it can be justified. If the claim under consideration can be supported, the result would seem to be this, that the whole of the shareholders, with the exception of those holding seven individual shares, might now be claiming payment of the sums paid upon their shares as against the creditors, who had a right to look to the moneys subscribed as the source out of which the company's liabilities to them were to be met. And the stringent precautions to prevent the reduction of the capital of a limited company, without due notice and judicial sanction, would be idle if the company might purchase its own shares wholesale, and so effect the desired result. I do not think it was disputed that a company could not enter upon such a transaction for the purpose of reducing its capital, but it was suggested that it might do so if that were not the object, but it was considered for some other reason desirable in the interest of the company to do so. To the creditor, whose interests, I think, §§ 8 and 12 of the Companies Act were intended to protect, it makes no difference what the object of the purchase is. The result to him is the same. The shareholders receive back the money subscribed, and there passes into their pockets what before existed in the form of cash in the coffers of the company, or of buildings, machinery, or stock available to meet the demands of the creditors.

What was the reason which induced the company in the present case to purchase its shares? If it was that they might sell them again, this would be a trafficking in the shares, and clearly unauthorized. If it was to retain them, this would be to my mind an indirect method of reducing the capital of the company. The only suggestion of another motive (and it seems to me to be a suggestion unsupported by proof) is that this was intended to be a family company, and that the directors wanted to keep the shares as much as possible in the hands of those who were partners, or who were interested in the old firm, or of those persons whom the directors thought they would like to be amongst this small number of shareholders. I cannot think that the employment of the company's money in the purchase of shares for any such purpose was legitimate. The business of the company was that of manufacturers of flannel. In what sense was the

expenditure of the company's money in this way incidental to the carrying on of such a business, or how could it secure the end of enabling the business to be more profitably or satisfactorily carried on? I can quite understand that the directors of a company may sometimes desire that the shareholders should not be numerous, and that they should be persons likely to leave them with a free hand to carry on their operations. But I think it would be most dangerous to countenance the view that, for reasons such as these, they could legitimately expend the moneys of the company to any extent they please in the purchase of its shares. No doubt if certain shareholders are disposed to hamper the proceedings of the company, and are willing to sell their shares, they may be bought out; but this must be done by persons, existing shareholders or others, who can be induced to purchase the shares, and not out of the funds of the company.

COPPIN *v.* GREENLEES & RANSOM CO.

38 Ohio St. 275. 1882.

The original action was brought by William Coppin, plaintiff in error, against The Greenlees & Ransom Company, defendant in error, in the court of common pleas of Hamilton county, and the cause of action was thus stated in the petition:

"The plaintiff states that the defendant is and for several years past has been a corporation, duly incorporated under the laws of the state of Ohio, for manufacturing purposes.

"That it has been the custom of said corporation that its officers and others, actively engaged in its service, should be holders of shares of its stock, and upon ceasing to be connected with said company, such persons have been accustomed to sell, and said company to buy their said stock.

"That the plaintiff was formerly in the employ of said company as a workman, and that while so engaged he became the holder of shares of the capital stock of said company to the amount, at its par value, of $3300.

"That having ceased to work for said company, he sought a purchaser for said stock, and offered to sell the same to the defendant for two lots of land, hereinafter described, valued respectively at $1100 and $700, and the balance of $1500 in manufactured work to be made by the defendant, at ten per cent. off their bill of prices, to which the defendant assented and agreed, and to carry the same into effect the plaintiff on May 28, 1875, caused to be prepared a written contract, which the defendant then duly executed and delivered to the plaintiff, of which the following is a copy:

"'CINCINNATI, May 28, 1875.

"'For and in consideration of thirty-three shares of the capital stock in the Greenlees & Ransom Company, the receipt whereof is hereby acknowledged, said Greenlees & Ransom Company promise to pay, or cause to be paid, to William Coppin the sum of three thousand three hundred dollars, payable, viz: said Coppen to take a lot of ground, No. 46 on the plat of the Wyoming Land and Building Co.'s subdivision of the Burn's farm, Wyoming, Ohio, in part payment, amounting to $1100.00; also a lot of ground on the north side of Wyoming avenue owned by ——— Caruthers, and next to Mr. Beeson's house, fifty feet front by two hundred and forty-five feet deep, more or less, for the sum of $700.00; leaving a balance of $1500.00 to be paid in manufactured work, joist, scantling, etc., the manufactured work at ten per cent. off their bill of prices; the other material at the usual rates; the work and material to be delivered from time to time to him as said Coppin may order it.

"'GREENLEES & RANSOM COMPANY.

"'By E. P. RANSOM, President.'

"And the plaintiff says that afterwards, in the month of June, 1875, he tendered said shares of stock to the defendant, and offered to transfer the same to it, and demanded performance of said contract; but the defendant refused to accept the same, and refused to convey said lots, or either of them, or to deliver said manufactured goods, although the plaintiff then demanded the same.

"Wherefore he now brings said stock into court, and offers to transfer the same to the defendant, and prays that the defendant may be compelled to convey said lots by a perfect title, and to deliver said goods, and for such other and further relief as in equity and good conscience he may prove to be entitled to."

MCILVAINE, J. Whether the defendant corporation was bound by its executory agreement with the plaintiff to purchase shares of its own stock, under the circumstances detailed in the petition, was, undoubtedly, the question upon which the case turned in the district court.

The power of a trading corporation to traffic in its own stock, where no authority to do so is conferred upon it by the terms of its charter, has been a subject of much discussion in the courts; and the conclusions reached by different courts have been conflicting. Of course, cases, wherein the power is found to exist by express or implied grant in the charter, furnish no aid in the solution of the question before us; unless the claim of the plaintiff can be sustained, that such power was conferred on the defendant by § 63 of the Corporation Act of 1852 (S. & C. 301), as amended, which confers on manufacturing corporations the powers enumerated in § 3 of the act, and, among others, the power "to acquire and convey, at pleasure, all such real and personal estate as may be necessary or convenient to

carry into effect the objects of the corporation." We think, however, that this claim cannot be maintained. The sole object of the defendant organization was "for manufacturing purposes;" and it cannot be said, in any just sense, that the power to acquire or convey its own stock was either necessary or convenient "for manufacturing purposes."

The doctrine that corporations, when not prohibited by their charters, may buy and sell their own stocks, is supported by a line of authorities; and, prominent among them, may be mentioned the cases of *Dupee* v. *Boston Water Power Co.*, 114 Mass. 37, and *C. P. and S. R.R. Co.* v. *Marsailles*, 84 Ill. 145. But nevertheless, we think the decided weight of authority both in England and in the United States, is against the existence of the power unless conferred by express grant or clear implication. The foundation principle, upon which these latter cases rest, is that a corporation possesses no powers except such as are conferred upon it by its charter, either by express grant or necessary implication; and this principle has been frequently declared by the supreme court of this state; and by no court more emphatically than by this court. It is true, however, that in most jurisdictions, where the right of a corporation to traffic in its own stock has been denied, an exception to the rule has been admitted to exist, whereby a corporation has been allowed to take its own stock in satisfaction of a debt due to it. This exception is supposed to rest on a necessity which arises in order to avoid loss; and was recognized in this state as early as *Taylor* v. *Miami Exporting Co.* 6 Ohio, 176, and has been incidentally referred to as an existing right since the adoption of our present constitution. *State* v. *Building Association*, 35 Ohio St. 258.

But, however that may be, the right of a corporation to traffic in its own stock, at pleasure, appears to us to be inconsistent with the principle of the provisions of the present constitution, art. 13, § 3, which reads as follows: "Dues from corporations shall be secured by such individual liability of stockholders, and other means, as may be prescribed by law; but, in all cases, each stockholder shall be liable, over and above the stock by him or her owned, and any amount unpaid thereon, to a further sum, at least equal in amount to such stock." Now, it is just as plain, that a business or trading corporation cannot exist without stock and stockholders, as it is that the creditors of such corporations are entitled to the security named in the constitution. *State ex rel. Att'y-Gen.* v. *Sherman*, 22 Ohio St. 411. The corporation itself cannot be a stockholder of its own stock within the meaning of this provision of the constitution. Nobody will deny this proposition. And if a corporation can buy one share of its stock at pleasure, why may it not buy every share? If the right of a corporation to purchase its own stock at pleasure, exists and is unlimited, where is the provision intended for the benefit of creditors?

This is not the security to which the constitution invites the creditors of corporations. I am aware, that the amount of stock required to be issued is not fixed by the constitution or by statute, and also that provision is made by statute for the reduction of the capital stock of corporations; but of these matters, creditors are bound to take notice. They have a right, however, to assume that stock once issued, and not called back in the manner provided by law, remains outstanding in the hands of stockholders liable to respond to creditors to the extent of the individual liability prescribed. In this view it matters not whether the stock purchased by the corporation that issued it, becomes extinct, or is held subject to be re-issued. It is enough to know that the corporation, as purchaser of its own stock, does not afford to creditors the security intended. And surely, if the law forbids the organization of a corporation without stock, because the required security is not furnished, it cannot be, that having brought the corporation into existence, it invests it with power to assume, at pleasure, the identical character or relation to the public, that was an insurmountable objection to the giving of corporate existence in the first place.

Plaintiff in error lays much stress on the averments in the petition, that it had been the custom of the corporation that its officers and others, actively engaged in its service, should be holders of shares of its stock, and upon ceasing to be connected with the company, such persons had been accustomed to sell, and the company to buy such stock; and that the plaintiff had purchased the stock for the price of which suit was brought while in the employment of defendant.

We cannot see why these averments should take the case out of the general rule.

If it were averred that the plaintiff had purchased this stock from the defendant, or from others, under an agreement with the company that it buy the same from him when he quit its employment, or if the contract of purchase by the defendant had been executed, very different questions would arise.

It is not even averred, that the plaintiff relied upon such custom either in making the purchase, or the sale, of the stock; so that, in fact, he is unaffected by the alleged custom. But if such custom had been relied on by the plaintiff when he purchased the stock, it would not have made the executory contract of the defendant to buy the stock binding, which, without such custom, would be void. The usage of a corporation does not become the law of its existence, or the measure of its powers. The general law of the state, of which all persons are presumed to have knowledge, is the source and limit of all its powers and duties; and these cannot be varied either by usage or contract. The doctrine of estoppel has no application in the case. Nor is there any such equity in the case, as would have arisen between the parties in case the contract had been executed.

Judgment affirmed.

NOTE. — See also *Vercoutere* v. *Golden State Co.*, 116 Cal. 410; *Crandall* v. *Lincoln*, 52 Conn. 73, 99; *Abeles* v. *Cochran*, 22 Kan. 405, 411 (*cf. Salt Co.* v. *Barber*, 58 Kan. 419); *Schaun* v. *Brandt*, 116 Md. 560; *Herring* v. *Ruskin Co-op. Ass'n*, 52 S. W. (Tenn.) 327.

CLAPP *v.* PETERSON.

104 Ill. 26. 1882.

MR. JUSTICE SHELDON delivered the opinion of the court:

By the will of her step-son, P. W. Bonner, who died in July, 1870, appellee, Georgie H. Peterson, a resident of the State of New York, became owner of all personal property left by said Bonner, and in September, 1870, on application made to her in New York, she sold all said property to the Illinois Land and Loan Company. On November 20, 1874, she filed her bill against said company to set aside such sale, and for other relief in respect thereto, on the ground that she had been induced to make the sale through the fraudulent misrepresentations of the company, for an inadequate consideration, and on May 1, 1877, she obtained in the suit a money decree against the company, for $5653.33. An execution issued upon the decree having been returned *nulla bona*, Mrs. Peterson, on September 18, 1879, filed her bill in chancery in the present case, to subject property in the hands of Caleb Clapp to the payment of this decree. A decree was entered in her favor granting the relief sought, which, on appeal to the Appellate Court for the First District, was affirmed, and the present appeal taken to this court.

It appears that the Illinois Land and Loan Company was chartered by an act of the legislature in 1867, with a capital stock of $100,000, with 1000 shares, of $100 each, all of which was paid in. Caleb Clapp, a non-resident of the State, was a stockholder in the company, and in January, 1874, he surrendered to the company 555 shares of stock, in consideration of which the company executed to him a deed of warranty of two lots in Chicago, one of the value of $50,000, and the other of the value of $5500, that amount being the consideration stated in the deed. The stock was canceled, and was considered, at the time, of par value. Mr. Clapp continued to be till his death, and his estate still is, the owner of the lots. It is these lots which are sought to be subjected to the payment of said money decree against the company.

The legal principle which appellants' counsel lays down and insists upon as applying to the case, is, that corporations may purchase their own stock in exchange for money or other property, and hold, re-issue or retire the same, provided such act is had in entire good faith, is an exchange of equal value, and is free from all fraud,

actual or constructive, this implying that the corporation is neither insolvent nor in process of dissolution. We think there must be added to the proposition the further condition that the rights of creditors are not affected.

The doctrine so elaborately urged by appellants' counsel, that a corporation has the power to purchase its own stock, seems well enough settled, and was asserted by this court in *Chicago, Pekin and Southwestern R.R. Co.* v. *Marseilles*, 84 Ill. 643. Yet, in so holding there, the qualification was added, that, in equity, the transaction might be impeached if it operated to the injury of creditors. We see nothing to show that the transaction in the present case was not in good faith, that there was any element of fraud about it, or that there was anything in the apparent condition of the company to interfere with the making of the exchange that was had. It is only as injuriously affecting the interests of creditors, we think, that the transaction can be questioned, and it is in that view that it must be considered and passed upon.

In *Sanger* v. *Upton*, 91 U.S. 60, it is laid down: "The capital stock of an incorporated company is a fund set apart for the payment of its debts. It is a substitute for the personal liability which subsists in private co-partnerships. When debts are incurred a contract arises with the creditors that it shall not be withdrawn or applied, otherwise than upon their demands, until such demands are satisfied. The creditors have a lien upon it in equity. If diverted, they may follow it as far as it can be traced, and subject it to the payment of their claims, except as against holders who have taken it *bona fide* for a valuable consideration and without notice. It is publicly pledged to those who deal with the corporation for their security." This doctrine is abundantly established by the authorities. 2 Story's Equity Jur. § 1252; *Wood* v. *Dummer*, 3 Mason, 308; *Spear* v. *Grant*, 15 Mass. 505; *Curran* v. *Arkansas*, 15 How. 304; *Bartlett* v. *Drew*, 57 N.Y. 587.

The shareholders of a corporation are conclusively charged with notice of the trust character which attaches to its capital stock. As to it they can not occupy the *status* of innocent purchasers, but they are to all intents and purposes privies to the trust. When, therefore, they have in their hands any of this trust fund, they hold it *cum onere*, subject to all the equities which attach to it. Thompson's Liability of Stockholders, § 13; *Wood* v. *Dummer*, 3 Mason, 312.

It is objected, against the principles above stated, that the cases in which they were declared were where there was actual or constructive fraud or unfairness, where the corporations were insolvent, or in process of being wound up. The question naturally would arise mostly in such circumstances, but the principles enunciated are general in scope, following from the nature of the capital stock of corporations, and the relation of a stockholder to the corporation,

and we know of no limitation of their application as above suggested, or reason for denial of their full applicability to the present case. Indeed, we do not understand appellants' counsel as asserting the validity of the purchase, or reduction by a corporation of its stock, where it should directly appear that it was an injury to its creditors. But it is denied that there was any such injury in this case. It is said, first, the company actually owed no one at the time, and even if it did, as the bill admits that the shares at the time of the exchange were valued at par, and worth full purported value, it follows from the stock being worth its par value, as a matter of course, that the company was then entirely solvent, and had assets sufficient to discharge all its debts, if it had any debts, and also to pay the stock in full, — that under no other circumstances could the admission of the bill be true. There was no proof as to the condition of the company, or the value of the stock, save the testimony of the secretary of the company that at the time of the deed to Clapp the stock in the company was at par value technically, — that he did not know what the market value was, and did not know that it had any market value. The admission of the bill was the simple fact that the stock was at par. The complainant, of course, knew nothing as to what made the stock at par. But if the stock was at par, in so rating it this indebtedness to appellee could not have been taken into account. It was supposed, of course, the purchase of personal property, which had been made of appellee, would stand, and that there was no liability on account of it. If, then, the stock was just at par, not considering appellee's claim with that claim recognized, the assets would have failed to pay the indebtedness of the company by the amount of her claim, to-wit, $5653.33, and to that amount the company was insolvent.

It is insisted that this exchange of corporate property for stock was unassailable by any one, because it was an exchange of equal values — the lots being worth $55,500, and the shares of stock being worth $55,500, there was equal value received, and there could be harm to no one. This can not be so, as respects creditors. Suppose all the remaining property of the company had been one other lot worth $44,500, and the company had made a like exchange with another stockholder of that lot for the remaining 445 shares of stock, and canceled the stock, what would there have been left to pay creditors? The partial exchange which was made affected the rights of creditors in a like way, only to a less extent. It is not as if there had been an exchange made with Clapp of these lots for other real property of equal value, or as if there had been a sale to him for $55,000 in money. In such case a substitute would have been furnished to the company to which creditors might have had recourse for payment of their debts. But the exchange of corporate property for shares of stock, and canceling the stock, furnishes no equivalent for creditors.

Although the money decree in favor of appellee was not obtained until in 1877, some time after Clapp's purchase, yet the cause of action of appellee against the company (the fraudulent purchase of the personal property from her) arose in September, 1870, which was before the purchase by Clapp, that being in January, 1874, so that at the time of Clapp's purchase appellee must be regarded as being a creditor of the company.

We can but regard the transaction in question, of the exchange of stock for the lots and the cancellation of the stock, as a withdrawal by the stockholder of his share of the capital stock, leaving appellee's debt against the company unpaid; that the transaction was to the injury of appellee as a creditor; that the property taken by Clapp stood charged with a trust for the payment of appellee's claim; that Clapp can not be held to be an innocent purchaser, and that the property in his hands is affected with the trust, and appellee may pursue the property and subject it to the satisfaction of her debt.

NOTE. — See, *accord*, *Hall* v. *Henderson*, 126 Ala. 449, 481; *Copper Belle Mining Co.* v. *Costello*, 12 Ariz. 318; *Oliver* v. *Rahway Ice Co.*, 64 N.J. Eq. 596.

A fortiori, the purchase is improper if at the time the corporation is insolvent in the sense that it has not assets equal to its liabilities, excluding its capital stock as a liability; or if it was in grave danger of becoming insolvent in this sense. *Tiger* v. *Rogers Cotton Cleaner Co.*, 96 Ark. 1; *German Savings Bank* v. *Wulfekuhler*, 19 Kan. 60; *Pender* v. *Speight*, 159 N.C. 612; *Adams Co.* v. *Deyette*, 8 S.D. 119.

Where the property of a corporation is in the hands of a receiver, a claim against the corporation for the price of stock sold to it may be deferred to the claims of other creditors. *Van Brocklin* v. *Queen City Printing Co.*, 19 Wash. 552.

DUPEE *v.* BOSTON WATER POWER CO.

114 Mass. 37. 1873.

BILL in equity by minority stockholders in defendant corporation, to restrain the corporation from selling land and receiving its own stock in payment.

COLT, J. At an annual meeting of the defendant corporation it was voted that the directors be authorized, "if in their judgment the interest of the company will be thereby promoted, to receive in part payment for the land of the company hereafter to be sold, the stock of the company, at such price for the land and the stock as may be deemed for the interest of the stockholders." Under this authority the directors advertised a number of lots belonging to the corpora-

tion to be sold at public auction, and paid for, at the option of the purchaser, one half in cash, and one half in the stock of the corporation at a price named. There is no other action of the corporation or its directors, past or contemplated, relied on to support the bill. The prayer is that the defendants be enjoined and restrained from selling the company's lands by auction, or otherwise, in the mode proposed.

There is nothing in this vote of the corporation, or in the action of the directors, which amounts to a reduction of capital, or will amount to it, if the proposed sales take place. That must depend on future corporate action. The answer denies that the sale proposed would be an improper and illegal reduction of capital, and the allegation in the bill that the plaintiffs are otherwise advised, as well as the further statement in the answer, that it has always been the policy of the company to reduce its capital in proportion to its sales, becomes immaterial. It is unnecessary, therefore, to consider the question somewhat discussed, whether, under St. 1870, chap. 224, § 24, this corporation could reduce its capital at any meeting not specially called for that purpose.

The corporation was chartered by the St. of 1824, chap. 26, with power to purchase and hold any quantity of water power created by the establishment of the dams between Roxbury and Boston, to make canals and raceways, erect buildings and fixtures, and to hold real estate not exceeding $300,000 at the time of its purchase, and personal property not exceeding $100,000. There are no limitations upon the amount of its capital stock, but the corporation had the right to make unlimited expenditures in the construction of its works necessary for the appropriation and use of the water power required under its charter, and the power to determine the amount of capital stock required to meet these expenses is left to the corporation itself. Additional acts, subsequently passed, authorize the company to hold additional real estate, but the terms of the original incorporation are not materially changed in other respects.

It is contended that a sale of the lands of the corporation in the mode proposed would be a breach of trust. This depends upon the question whether a sale on such terms is by reasonable implication within the chartered powers of such a corporation. It is not enough that the proposed action may be shown to be prejudicial to the general corporate interests, if it is not illegal, and if it equally affects all the corporators. Regard must be had to the peculiar situation of the property. The increase of population since the original act of incorporation has given greatly increased value to the lands acquired by the company. The business of the company can no longer be profitably confined to the development and use of its water privileges. It has, by contract with the Commonwealth, the city, and other owners of lands, extinguished its water power, and now owns in-

stead thereof extensive and valuable tracts of lands, over which it had originally only the right to flow. This change in its business has made it necessary to fill in and improve the land that it might be made available as assets of the company, and this necessity has been recognized by a resolve of the legislature authorizing an increase of capital for that purpose. Res. 1856, chap. 76.

There is nothing in the general laws of the Commonwealth, or in the company's charter, which forbids the sale proposed. The power to purchase and hold implies the power to sell, and to sell upon such terms as to secure the highest price. The whole capital is now represented by these lands, from the sale, and not from the income or use, of which the shareholders must derive their return. In the absence of legislative provision to the contrary, a corporation may hold and sell its own stock, and may receive it in pledge or in payment in the lawful exercise of its corporate powers. *Leland* v. *Hayden*, 102 Mass. 542. *American Railway-Frog Co.* v. *Haven*, 101 Mass. 398. *Nesmith* v. *Washington Bank*, 6 Pick. 324, 329. *Coleman* v. *Columbia Oil Co.*, 51 Penn. State, 74. *City Bank of Columbus* v. *Bruce*, 17 N.Y. 507. *Ex parte Holmes*, 5 Cowen, 426.

We cannot see that the rights of any of the stockholders will be illegally prejudiced by the proposed receipt of the shares in payment for its land.

NOTE. — See also *Republic Life Ins. Co.* v. *Swigert*, 135 Ill. 150; *West* v. *Averill Grocery Co.*, 109 Iowa, 488; *Cole* v. *Cole Realty Co.*, 169 Mich. 347; *Forrest* v. *Nebraska Hardware Co.*, 91 Neb. 735; *Chapman* v. *Iron Clad Co.*, 62 N.J.L. 497; *San Antonio Hardware Co.* v. *Sanger*, 151 S.W. (Tex. Civ. App.) 1104; *United States Mineral Co.* v. *Camden*, 106 Va. 663; *Shoemaker* v. *Washburn Lumber Co.*, 97 Wis. 585.

Of course the purchase must not be made under such circumstances that it is unfair to other stockholders, — as by undervaluing the assets of the corporation given in exchange. See *Woodroof* v. *Howes*, 88 Cal. 184; *Price* v. *Pine Mountain Co.*, 32 S.W. (Ky.) 267.

MARVIN *v.* ANDERSON.

111 Wis. 387. 1901.

ACTION by the trustee in bankruptcy of the property of the Badger Cycle Company to set aside a deed, given by the bankrupt some time before the commencement of the bankruptcy proceedings, upon the ground that it was fraudulent as to the creditors and stockholders of the corporation. The court decided as matters of fact as follows:

On October 22, 1897, the day when the deed was given to de-

fendant *Louis Anderson*, he was and for some time prior thereto had been a stockholder of the corporation, possessed of five out of the fifty shares of its capital stock, each share being of the par value of $100, and was also a director of the corporation and the foreman of its business. At such time the corporation was indebted to its stockholders in the sum of $1,573, $803 of which was due to *Anderson* for labor and services; was also indebted to outside parties in the sum of $5,444.32; and possessed property of the value of from nine to ten thousand dollars, being solvent and in every respect a going corporation. *Anderson*, upon the advice of his physician, decided to discontinue his work for the corporation, and thereupon requested it to pay him the amount due for his services. It being difficult for the corporation to comply with such request by paying *Anderson* in money, the parties agreed, without any formal action by the directors as a board or by the stockholders, but upon their individual consideration and determination, that plaintiff should release his claim against the corporation and transfer to it his five shares of capital stock, and receive therefor the real estate in question, which was of the value of $850 and was not used in the corporate business, four bicycles of the value of $20 each, and $225 in money, which agreement was fully consummated. All the stockholders and directors had knowledge of and fully acquiesced in the entire transaction, and after it occurred treated it as valid till after the commencement of the proceedings in bankruptcy nearly two years subsequent to the making of the deed. Aside from claims of stockholders of the corporation who acquiesced in the transaction in question, the only claim proved in bankruptcy which existed at the time of such transaction was a small one in favor of one Comstock, which, prior to the commencement of this action, was fully paid. After the making of the deed and before its validity was in any way called in question, *Anderson* mortgaged the land to defendant *John Gilbert* to secure the payment of a loan of $200.

MARSHALL, J. If the Badger Cycle Company was solvent at the time of the transaction in question, the main contention by counsel for appellant, that the judgment appealed from is wrong, fails. The trial court decided that question in the affirmative because the property of the corporation, at a fair valuation, exceeded to a considerable extent its debts. Appellant's counsel say that was not the proper rule to be applied. The conclusive answer thereto is that the trial court followed the law as it has been laid down by this court. *Hamilton* v. *Menominee Falls Q. Co.*, 106 Wis. 352; *Shaw* v. *Gilbert*, 111 Wis. 165. Counsel makes the common mistake of failing to distinguish between the meaning of the term "insolvent," as the subject of insolvency is dealt with by insolvent and bankrupt laws, and the general meaning thereof. The former is inability of a person to pay his debts as they mature in the ordinary course of business; the latter

is a substantial excess of a person's liabilities over the fair cash value of his property. The former does not militate against a debtor corporation dealing with its property as it sees fit; while the latter, in case of a corporation, if it is on the verge of collapse or has suspended payment — is in a condition, as the books say, to be rightfully considered, so far as capacity to do business is concerned, civilly dead — is held to impress upon its property a trust for the benefit of its creditors. *Hinz* v. *Van Dusen*, 95 Wis. 503; *Shoemaker* v. *Washburn L. Co.*, 97 Wis. 585; *Graham* v. *Railroad Co.*, 102 U.S. 148; *Slack* v. *N.W. Nat. Bank*, 103 Wis. 57; *Hamilton* v. *Menominee Falls Q. Co., supra.*

The further question is presented of whether the corporation was justified, as to its creditcrs or stockholders, in purchasing its own stock and parting with corporate property in payment therefor. There is no impediment in the way of a solvent corporation, having power to purchase and sell and convey property and not prohibited by its constitution or any statute, from buying in its own stock. This court has several times passed upon that question. *Shoemaker* v. *Washburn L. Co., supra; Calteaux* v. *Mueller*, 102 Wis. 525. It was held in the last case cited that such rule could not be invoked to justify an officer of a corporation, without special authority, in buying in its capital stock in its name, but that situation does not apply in this case, since all the stockholders of the cycle company knew of and individually considered and approved the transaction in question before it occurred, and thereafter, so long as the corporation existed as a business institution, a period of some two years, acquiesced in it.

If under any circumstances the sale of land to respondent could be impeached on the ground of fraud or want of power in the corporation to make the sale, appellant has no standing in court to do so, since all the stockholders are estopped by their conduct from complaining, and the receiver, as the representative of the corporation, has no better right in their behalf. Further, there is no indebtedness to any nonstockholder of the corporation which existed at the time the transaction took place. *Shoemaker* v. *Washburn L. Co., supra; Graham* v. *Railroad Co., supra.* Here again counsel seem to have fallen into a common error, that of not keeping in mind that the rule under which, in any case, the property of a corporation is deemed a trust fund for creditors and stockholders, or either, is wholly a creation of courts of equity, and that only those have equitable rights in a fund at the time of its depletion who have then a right to resort to such fund to satisfy their claims. Creditors of a corporation are not presumed to have relied upon property of their debtor which it did not possess when the indebtedness accrued, and therefore are not held to have any equitable claim thereon.

NOTE. — See also *Blalock* v. *Kernersville Mfg. Co.*, 110 N.C. 99; *Joseph* v. *Raff*, 82 N.Y. App. Div. 47; aff'd, 176 N.Y. 611.

RICHARDS *v.* WIENER CO.

207 N.Y. 59. 1912.

HIAGHT, J. This action was brought to recover the sum of $3,000 and interest thereon, claimed to be due from the defendant under a written contract, which is as follows:

"NEW YORK, *October* 24, 1908.

"MR. J. N. RICHARDS,

"New York City:

"DEAR SIR. — We beg to confirm our agreement with you as follows:

"(1) You subscribe for 100 shares of our 6 per cent preferred stock of a par value of $100.00 at the price of $10,000 and you agree to pay not less than $3,000.00 immediately ($1,000.00 at the time of signing this contract, $2,000.00 on or before November 10th, 1908), not less than $5,000.00 within 6 months after date and the balance within 3 months thereafter, that is 9 months from date.

"(2) In consideration of this purchase of our stock, we agree to employ you in our business and you agree to devote to same your entire time exclusively and to use your very best efforts to further its interest directly or indirectly. We agree to allow you a salary of $50.00 per week and a commission on all the new business that you bring us, that is, on all orders from customers, whose first order has been obtained by you. This commission to be 10 per cent on the net profits of such orders. Such profits to result in deducting from the sales price all the expenses had with the order, as f.i., the cost price of the material figures in the regular way, discounts, freight and cartage allowances, etc. Among the expenses on the order to be counted the interests from date of expenditure until date of payment by the customer, all special expenses such as telegrams, long distance telephone messages, traveling expenses if incurred especially, shares of profit to manufacturers if any, and outside commissions, but no general office expenses.

"(3) As soon as you have paid the second installment of $5,000.00 on the above purchase of preferred stock, we will guarantee you the above commission in addition to the salary with $600.00 per year and we will sign a contract with you on this basis, to be good for not less than 2 years from the date of this letter.

"If, however, you should fail to pay the second installment, we will have the option to discontinue your employment, and if in this case you should not want to have the first installment paid by you considered as the purchase price in full for 30 shares of our preferred stock, then we shall repurchase these 30 shares of stock from you at par within 6 months thereafter. If, however, at any time during the first 6 months or at the end of same you should discon-

tinue your services of your own account and fail to pay in the $5,000.00, then the first installment of $3,000.00 paid in by you shall be considered as the purchase price in full for 30 shares of our preferred stock without any obligation on our part to repurchase same.

"In case this agreement should be terminated the commission will be paid on all orders coming under this agreement, such as have been received in our office, before the date of expiration of this contract whether accepted and executed before this date or thereafter.

"Please acknowledge this agreement, and oblige,

"Yours very truly,

"ERNST WIENER COMPANY,

"WALTER J. BRIGGS, *Sec'y.*"

It appears that the plaintiff thereupon paid to the defendant the sum of $3,000, being the first of the two sums mentioned in the contract, and then entered the employment of the defendant and continued therein until the 14th day of August, 1909. He did not, however, at the expiration of the six months pay the additional sum of $5,000 upon the contract, but notified the defendant that he was unable to do so. Thereupon and on the 14th day of August, 1909, the defendant wrote the plaintiff as follows: "After a fair trial we have come to the conclusion that you are not competent to fill the position now occupied by you nor do the results warrant our keeping you, and we, therefore, beg to notify you that with the payment of this week's salary your services will not be required after this date." (Signed by the defendant company.) At the same time the defendant company drew a certificate for thirty shares of preferred capital stock of the corporation and delivered the same to the plaintiff. Thereupon the plaintiff wrote the defendant as follows: "Having received from you under date of the 14th notice that my services were no longer required by your Company, I beg to notify you that I shall require you to repurchase from me thirty (30) shares of your preferred stock for which I have heretofore paid you the sum of Three Thousand ($3,000) Dollars, but which stock was never delivered to me, as I do not wish to have the money paid in by me under the contract between us bearing date October 24th, 1908, considered as the purchase price of said thirty (30) shares." The chief defense interposed in the case is to the effect that the provision of the contract with reference to purchasing back the stock was void and contrary to the provisions of the Penal Law and is contrary to public policy and to the law. § 664 of the Penal Law, formerly § 594 of the Penal Code, provides as follows:

"A director of a stock corporation, who concurs in any vote or act of the directors of such corporation, or any of them, by which it is intended: . . .

"5. To apply any portion of the funds of such corporation, ex-

cept surplus profits, directly or indirectly, to the purchase of shares of its own stock, is guilty of a misdemeanor."

We are much impressed with the contention that the contract in this case, properly construed, amounts merely to an option to purchase stock on the part of the plaintiff, and the advancement on such option of $3,000 upon condition that he be given employment by the corporation at the price agreed upon, and that in case the company terminated such employment he had the right to demand the return of the money that he had advanced. But we have thought it wise in this case to follow the Appellate Division. Assuming, therefore, that under the contract the plaintiff had the title to the stock which he could resell but for the provision of the Penal Law, the defendant nevertheless was required to prove its invalidity, under the law referred to. Upon the trial there was an attempt to show that the corporation had no surplus profits out of which the purchase of the stock could be made. But the evidence offered upon this subject was not proper and consequently was excluded by the trial court. We, therefore, have a case in which the corporation has failed to show that it did not possess surplus profits out of which the stock could be purchased. As was said by SCOTT, J., below: "The law will not presume, unless forced to do so, that a person intends to do an illegal act. It will not, therefore, presume that the parties intended to make an illegal contract. The contract itself, therefore, was perfectly legal subject to certain limitations upon its enforcibility. If when the time came defendant had a sufficient surplus the contract would be enforced. If it had not the contract could not be enforced. In defending against plaintiff's attempt to enforce it the burden rested upon defendant to show that it would be illegal to do so, for there is no presumption one way or the other as to the existence of a surplus. The defendant assumed this burden but failed in sustaining it, . . ."

The judgment appealed should be affirmed, with costs.

Judgment affirmed.

CULLEN, Ch.J., VANN, WILLARD BARTLETT, HISCOCK and CHASE, JJ., concur; COLLIN, J., absent.

MORGAN *v.* LEWIS.

46 Ohio 1. 1888.

THE action below was commenced by Lewis, one of the defendants in error, against the Alliance Rolling Mill Company and other defendants alleged to be stockholders in, or creditors of, the company, for the purpose of enforcing the statutory liability of the stockholders to contribute to the payment of the debts of the corporation, which

was alleged to be insolvent, and to have assigned its property and ceased to do business.

The case was referred; there was a trial before the referee, and Morgan, the plaintiff in error, was held as a stockholder. He excepted, and had a bill of exceptions signed by the referee. On hearing, the court of common pleas affirmed the referee's report, Morgan excepting. He then presented a petition in error in the district court where the case was reserved for decision in this court.

Upon the trial before the referee, Morgan offered to prove that prior to the time the Alliance Rolling Mill Company acquired title to the furnace property, the property was principally owned by the defendant, Morgan, and that for his interest in the furnace property the Alliance Rolling Mill Company issued to the defendant, Morgan, stock in the Rolling Mill Company, which stock was the same stock which was afterwards transferred by the defendant, Morgan, to the Alliance Rolling Mill Company in consideration of the re-transfer to him of the furnace property. And further offered to prove, that after the Alliance Rolling Mill Company acquired title to the furnace property, the furnace not proving as successful and profitable as had been expected, some of the stockholders were dissatisfied with the purchase from Morgan, and contentions arose among them, and the defendant, Morgan, was blamed by many of them for having gotten the company into the purchase and was requested to take the property off their hands and pay for it in stock of the company; and that Morgan, for the sake of settling such contentions and dissatisfaction, did purchase the furnace and pay for it in stock which had been issued to him as shown by the record. And thereupon the referee sustained the objection to the evidence so offered, and defendant, Morgan, excepted.

It was testified to before the referee, and not contradicted, that Morgan transferred his stock to the company and the latter deeded to him the furnace property, of which he took immediate possession, and which he continued to hold and use as his own.

No action has been taken looking to the subjection of this furnace property to the payment of the claims of any creditors, but all parties have treated it as if it were the property of Morgan since it was so deeded to him.

In his report the referee finds that between February 5, 1867, and January 2, 1871, Morgan became the legal owner and holder of $116,583 worth (at par value) of stock in the company. That on the 17th of January, 1872, "by a resolution of the said board of directors, the president of said corporation, by deed duly executed, deeded the furnace property mentioned in said proposition to said David Morgan, and on the same day said David Morgan signed powers of attorney in blank, transferring said stock, and delivered up the certificates of the same to the secretary of the corporation, who

wrote the word 'cancelled' on the face of each certificate, and inserted said certificates in the stock certificate book of the corporation, as surrendered stock.

"That at the time of said delivery of said certificates of stock to said corporation said David Morgan was the legal owner of said stock represented thereby.

"That said stock so delivered and intended to be surrendered to said corporation, was never afterwards represented, and the same was completely merged in said corporation, and the capital stock of said corporation was treated by the directors as reduced by the amount of $116,583.

"Said transaction was with the directors of said corporation alone, and without any submission of the same to, or vote on the same by, the general stockholders of said corporation, and without any knowledge or assent of the general stockholders, and that no certificate of decrease was filed with the Secretary of State as required by statute, nor was any notice of the action of the directors ever given.

"That at the time of said attempted surrender said corporation was reported to be solvent.

"That said David Morgan bought said property from, and intended to transfer said stock to, said corporation in good faith and without fraudulent intent.

CONCLUSIONS OF LAW.

"The transfer of this stock to the corporation had the effect of reducing the capital stock of the corporation; the directors of the corporation did not have the power to thus reduce the capital stock, and such transfer is void and of no effect, and left the title to said $116,583 of stock precisely where it had been, and the same as if no effort had been made to transfer the same.

"Unless the power to buy its own stock is expressly conferred in its charter, a corporation can not deal in its own stock, and such transactions are void.

"The fund arising from the individual liability of stockholders is a trust fund set apart under our constitution and statutes for the benefit of creditors, and the directors by no arrangement or dealing whatever can affect or impair this fund.

"I find David Morgan liable on account of said stock, to contribute to the payment of the claims of the creditors of said corporation, to the amount of $116,583."

The referee finds in another connection, that the capital stock of the company was increased from time to time, until in December, 1870, when it was increased to $450,000.

The fact that Morgan took immediate possession of the furnace property upon its conveyance to him, is not found by the referee,

and does not seem to have entered into the consideration of the case by him, or by the court of common pleas.

It also appeared in the case that the claims of creditors all accrued after the transfer by Morgan of his stock to the company, and of the furnace property, by the latter, to him.

OWEN, C.J. The theory upon which the referee and the court of common pleas must have proceeded, was that the entire transaction by which Morgan acquired the furnace, and the company acquired his stock, was void; that it was beyond the power of the company to engage in the transaction, and that consequently the company acquired no title to the stock, and Morgan acquired none to the furnace property. If this conclusion is sound, the inevitable consequence is, that the company still owns the furnace, and it is assets in the hands of the assignee for the payment of the company's debts. It is an absurdity to assume that Morgan is still the owner of both the furnace and the stock. If he is still liable to creditors as a holder of this stock, the company, by the same reasoning, is owner of the furnace. It is conceded that the proceeding to subject the liability of stockholders to the satisfaction of the claims of creditors, has throughout ignored this property. It does not appear but that this property alone would satisfy creditors, nor to what extent it would exonerate stockholders from the liability which it is now sought to subject to the satisfaction of creditors' claims. If we were in accord with the referee and court of common pleas, upon the main proposition of the case, still it would be our duty to send the case back for proceedings to subject this property of the company to the satisfaction, *pro tanto*, of its debts.

We are of opinion, however, that the referee erred in excluding the evidence which Morgan offered, to throw light upon the transaction by which he assumed to acquire the furnace, and transfer his stock to the company.

The contention of Morgan, in this respect, is not answered by the proposition that the only purpose of offering the rejected proof was to show that the transaction was in good faith, and that this already sufficiently appeared. We have no disposition to call in question the general and well recognized principle that a corporation cannot buy its own stock. It is conceded that this principle proceeds upon a want of power, rather than upon any express prohibition in its charter. With this general principle conceded, however, the right of a corporation to take its own stock in satisfaction of a debt due to it, has long been recognized in this state.

This has been recognized as an exception supposed to rest upon the necessity of avoiding loss. *Coppin* v. *Greenlees*, 38 Ohio St. 279. It is, nevertheless, a relaxation of the general rule. It is, of course, because of the necessity of avoiding loss, and not because it is for the satisfaction of a debt, that the exception is recognized. If the same or a like

necessity of avoiding loss should arise in any of the transactions of the company, it could not, with any show of reason, be contended that the application of this principle of necessity should be limited by any iron rule to the case of taking stock for an otherwise hopeless debt.

The evidence which Morgan offered, and the referee rejected, tended to establish, in substance, that Morgan had traded to the company this furnace property for stock. That the furnace promised to prove a failure, or, at best, a disappointing and unsatisfactory venture. Contentions arose over the transaction, between Morgan and some of the stockholders. Many of them blamed him for having induced the company to make the purchase. Thereupon they — "many stockholders" — simply proposed a rescission of the contract of purchase; that Morgan take back the furnace and restore to the company the stock he had received for it. The company was out of debt. Nobody could possibly be hurt by a rescission of this contract which had caused so much discontent and contention, and which promised to be a losing venture for the company and Morgan's fellow stockholders. This proof would have established something beyond the mere good faith of the transaction. It would have tended to establish the fact that Morgan yielded to the importunities of many stockholders to rescind a bargain and set at rest an unfortunate controversy which was rapidly breeding discord among the stockholders.

The finding of the referee, that this transaction itself worked a reduction of the capital stock of the company, is not tenable. There was nothing in the way of the company re-issuing this stock or its equivalent to others who may have desired it. There was nothing in the fact that these certificates were marked "cancelled" on the face, by the secretary of the company, and by him treated as surrendered stock, to authorize the finding that the capital stock of the company was reduced. This was no part of the transaction with Morgan, and there was nothing in the fact of the re-exchange of the stock for the furnace which called upon the officers of the company to treat the stock as cancelled, or the capital *pro tanto* reduced. Green's Brice's Ultra Vires, 2d ed., 191, 192. This conclusion is not, in principle, qualified by the fact that the stock was not in fact thereafter represented. Then, we should not lose sight of the fact that there was an executed transaction. The exchange — or the re-exchange, rather — had been made, possession of the furnace taken by Morgan, and retained by him for years before the transaction was questioned by any one. To this day it has remained free from direct attack. Certainly, the possession by Morgan of this property which had theretofore been in the possession of the company, was a circumstance proper to be considered with other facts in the case. It at least helps us to distinguish it from the case of *Coppin* v. *Greenlees*,

38 Ohio St. 275, relied upon by defendants in error. In that case it was held that: "An executory agreement between a manufacturing corporation of this state and one of the stockholders, for the purchase of the stock of such corporation, by the former from the latter, can not be enforced, either by action for specific performance or for damages." That this presents a very different case from one of an executed contract is emphasized by the following language of McIlvaine, J., by whom the opinion was prepared: "If it were averred that the plaintiff had purchased this stock from the defendant, or from others, under an agreement with the company that it buy the same from him when he quit its employment, *or if the contract of purchase by the defendant had been executed, very different questions would arise.*" In *State* v. *Building Association*, 35 Ohio St. 263, the general principle that a corporation may not traffic in its own stock is recognized. Yet in the same connection it is said: "We do not deny that a corporation has power to receive shares of its stock as security for a debt *or other similar purposes.*" 26 Ga. 28; 84 Ill. 145; 17 N.Y. 507; 114 Mass. 37; 18 Vt. 131. It is apparent from the foregoing that no inflexible rule has been recognized by this court, that a corporation may not in any case, nor for any purpose, receive its own stock. On the contrary, the way is left open for the application of exceptions to the general rule in proper cases. It is one of the established facts in the case that all the debts which are sought to be satisfied by this proceeding were contracted subsequently to the transaction which is assailed. The transfer of the furnace property from the possession of the company to that of Morgan was a fact to which persons giving credit to the company could not safely close their eyes. The inquiry which it would naturally excite would have led to the information that the trade by which the company secured the furnace, and Morgan the stock, had simply been rescinded and the property — stock and furnace — re-exchanged. It being the law of our state that there are exceptions to the general rule, that corporations may not deal in their own stock, all persons dealing with this company must be held to have done so in the light of this state of the law. All persons are as much presumed to know of exceptions to a principle as of the principle itself. The slightest inquiry would have revealed the fact, that, as between himself and the company, Morgan did not sustain the relation of stockholder, at the time these debts were contracted.

In the light of this state of adjudication in this court, we do not hesitate to say that the peculiar state of circumstances, which Morgan offered to prove before the referee, ought to have been received in evidence and considered in the light of other facts which did appear, in order that the referee and courts could have had an opportunity to say whether they did not bring the case within some of the well founded exceptions to the wise and well-established general rule.

The facts alleged in the petition, concerning the insolvency, etc.,

of the company, were sufficient to dispense with an averment of the recovery of a judgment against it as a prerequisite to the proceeding to subject the liability of the stockholders to the satisfaction of the corporate debts.

Judgment reversed and cause remanded.

NOTE. — It was held that the corporation in question had power to take its own stock in payment of a previously existing debt in *Draper* v. *Blackwell*, 138 Ala. 182; *Costello* v. *Portsmouth Brewing Co.*, 69 N.H. 405; *City Bank* v. *Bruce*, 17 N.Y. 507; *Taylor* v. *Miami Co.*, 6 Ohio, 177; *Barto* v. *Nix*, 15 Wash. 563. So, of taking its own stock as collateral. *Red Bud Realty Co.* v. *South*, 96 Ark. 281.

VENT *v.* DULUTH COFFEE CO.

64 Minn. 307. 1896.

CANTY, J. On April 23, 1894, plaintiffs and the defendant corporation (then called the Smith & Coulter Spice Company) entered into the following agreement: "Parties of the first part [plaintiffs] agree to take five thousand ($5,000) dollars' worth of capital stock of the Smith & Coulter Spice Co.'s stock at par value, to be paid for on or before May 1st, '94, which is to represent one-fourth interest in all assets of the company at this date. Parties of the second part [defendant] agree that on April 1st, 1895, if said parties of the first part are dissatisfied with the said stock or interest in said company, that the said Smith & Coulter Spice Co. will take stock from said parties of the first part, and pay them par value in cash for said stock, or interest in said company; parties of the first part to give notice by April 15th, 1895, and parties of the second part to have 60 days from said notice to pay for said stock." Pursuant to this agreement, defendant issued the $5,000 of its stock to plaintiffs, who paid for the same in full. The name of the defendant has since been changed to the Duluth Coffee & Spice Company. On April 1, 1895, plaintiffs notified defendant that they were dissatisfied with the stock, offered to return the same, and demanded that they be paid the price of the same. On April 14 the demand was renewed, and the stock again offered to defendant. Defendant has not accepted the stock, or paid for the same, and, after the 60 days mentioned in the contract, this action was brought to recover the $5,000 so paid for the stock. On the trial the court ordered a verdict for plaintiffs for the amount claimed. From an order denying its motion for a new trial, defendant appeals.

We are of the opinion that the evidence conclusively establishes all of the foregoing facts, and the only point raised by appellant

worthy of consideration is the contention that the part of the contract by which defendant agreed to purchase or accept a surrender of its own stock is *ultra vires* and void. There is no express provision in its articles of incorporation authorizing defendant to buy or deal in its own stock, and whether an original, independent contract, by which it agreed to purchase its own stock, would be *ultra vires*, we need not consider. This is not such a case. This provision of the contract constituted a material and substantial part of the consideration and inducement for the purchase of the stock by plaintiffs, and, if the provision is void, it seems to us that it vitiates the whole contract, and is a sufficient reason for the rescission of that contract and the return of the purchase price, which purchase price plaintiffs are demanding. But the better opinion, it seems to us, is that which holds the original contract to be a conditional sale, with the option to revoke or rescind in the purchaser. In *Browne* v. *St. Paul Plow Works*, 62 Minn. 90, 64 N.W. 66, we held that a similar contract was not *ultra vires*. There is no question here as to the rights of creditors.

Order affirmed.

NOTE. — See also *Iowa Lumber Co.* v. *Foster*, 49 Iowa, 25; *Adam* v. *New England Investment Co.*, 33 R.I. 193; *Rogers* v. *Building Ass'n*, 30 Utah, 188; *Yeaton* v. *Eagle Oil Co.*, 4 Wash. 183. *Cf. Sarbach* v. *Fiscal Agency Co.*, 86 Kan. 734.

In *Mulford* v. *Torrey Co.*, 45 Colo. 81, the court said (p. 85): "The statute upon which the defense is based, to the effect that the contracts in question are in violation of the statutes of the State, is as follows: 'It shall not be lawful for such corporations to use any of their funds for the purchase of stock in their own company or corporation, except such as may be forfeited for the non-payment of assessments thereon, except as hereinafter provided.' § 485, 1 Mills' Ann. Stats.

"This statute does not apply. The company desired to sell its treasury stock. It received the consideration agreed upon therefor. The plaintiff only purchased upon the condition that he should have the right to return the stock and have the consideration which he gave therefor returned to him. There was but one contract, namely, for the sale and repurchase of the stock, each object being a consideration for the other. The sale was, therefore, conditional. Such a transaction is not prohibited by the statute."

See also *Sweeney* v. *Underwriters Co.*, 29 S.D. 576.

CHAPTER II.

THE EXERCISE OF THE POWERS.

SECTION 1.

IN WHOM THE POWERS ARE VESTED.

NORTH MILWAUKEE TOWN SITE NO. 2 *v.* BISHOP.

103 Wis. 492.

The defendant was the owner of shares of stock in the plaintiff. The directors of the plaintiff resolved that the stock of the company, to the extent that it had not previously been paid for, should be paid. This action was brought to recover from the defendant the amounts unpaid on his shares.

Bardeen, J. The judgment of nonsuit was justified upon either of two grounds: . . .

No proof was made of giving notice of such call according to the by-laws of the corporation. § 1754, Stats. 1898, provides that, "unless otherwise expressly provided by law or the articles of organization, the directors of any corporation may call in the subscriptions to the capital stock by instalments, in such proportion and at such times as they shall think proper, by giving such notice thereof as the by-laws shall prescribe."

It was admitted on the trial that no by-law of the corporation in this regard had ever been adopted. The action of the board was attempted to be justified, however, by showing that the board, after adopting the resolution for the call, adopted another resolution instructing the secretary to notify each stockholder thereof by mailing to him a copy of said resolution. This latter action of the board is claimed to be equivalent to a regular by-law, and answers all the purposes of the statute. The difficulty with this contention is that the board of directors have no power to enact by-laws unless so authorized by law, by the articles of organization, or by proper action of the stockholders. A by-law is a permanent and continuing rule for the government of the corporation and its officers. The power to enact them resides primarily with the stockholders. They have few functions to perform, and this right to make by-laws is an essential and an important one. It is a power that the directors have no inherent right to exercise. This is the rule laid down by the textwriters,

and finds ample support in the authorities cited in the following works: 2 Cook, Stock, § 700*a;* 1 Thomp. Corp. § 956; Ang. Corp. § 327. In the *Germania Case* cited, it is said: "We hold, therefore, that it was intended that the statutory method of making calls should supersede previous common-law methods, and to prescribe a uniform and reasonable rule easily complied with"; and it was accordingly held that a complaint which did not allege that a call was made by giving such notice as the by-laws prescribed fails to state a cause of action. For the same reason such an action cannot be sustained until *proof* is made in conformity to these requirements. It is argued, however, that because § 1776, R.S. 1878, provides that "the stock, property, affairs, and business" of every corporation shall be under the care of and be managed by a board of directors, the power to enact proper by-laws may be implied therefrom. As before intimated, the power to make by-laws is incident to the corporation itself, and results from the necessity of such a power to enable the body politic to answer to the purposes for which it was created. It being a valuable and important right, it ought not to be taken away by inference or implication. The power given to the directors to control the stock and business of the corporation may exist, and be entirely consistent with the power of the stockholders to say upon what terms and conditions the stock of the corporation shall be paid for and issued. We therefore hold that, unless taken away by the charter or some law of the state, the power to enact suitable by-laws rests in the stockholders of the corporation, and not in the board of directors. Our attention has been called to some expressions used in the opinion in *In re Klaus*, 67 Wis. 401, to the effect that the directors, and not the stockholders, may make the by-laws. As we have seen, this statement of the law is contrary to all of the adjudicated cases, and cannot be sustained on principle, and was in fact not necessary to the question decided. In that regard it must be deemed to be overruled.

By the Court. — The judgment of the superior court of Milwaukee County is affirmed.

NOTE. — See, *accord, Morton Gravel Road Co.* v. *Wysong*, 51 Ind. 4. See also *Trust & Savings Co.* v. *Home Lumber Co.*, 118 Mo. 447. *Cf. Manufacturers' Building Co.* v. *Landay*, 219 Ill. 168, where the court held that by the statute in question the power of making by-laws had been vested in the directors.

The power to elect directors is usually vested exclusively in the stockholders. See *Durkee* v. *The People*, 155 Ill. 354; *State* v. *Merchant*, 37 Ohio, 251.

CHICAGO CITY RAILWAY CO. *v.* ALLERTON.

18 Wall. (U.S.) 233. 1873.

THE charter of the Chicago City Railway Company contained the following provisions:

§ 3. The capital stock of said corporation shall be one hundred thousand dollars, and may be increased from time to time, at the pleasure of said corporation.

§ 4. All the corporate powers of said corporation shall be vested in and exercised by a board of directors, and such officers and agents as said board shall appoint.

The directors, without consulting the stockholders, resolved to increase the capital stock. To this one Allerton, who was a stockholder, objected, and filed a bill praying for an injunction to prevent the increase.

MR. JUSTICE BRADLEY delivered the opinion of the court.

We are satisfied that the decree must be affirmed on the broad ground that a change so organic and fundamental as that of increasing the capital stock of a corporation beyond the limit fixed by the charter cannot be made by the directors alone, unless expressly authorized thereto. The general power to perform all corporate acts refers to the ordinary business transactions of the corporation, and does not extend to a reconstruction of the body itself, or to an enlargement of its capital stock. A corporation, like a partnership, is an association of natural persons who contribute a joint capital for a common purpose, and although the shares may be assigned to new individuals in perpetual succession, yet the number of shares and amount of capital cannot be increased, except in the manner expressly authorized by the charter or articles of association.

Authority to increase the capital stock of a corporation may undoubtedly be conferred by a law passed subsequent to the charter; but such a law should regularly be accepted by the stockholders. Such assent might be inferred by subsequent acquiescence; but in some form or other it must be given to render the increase valid and binding on them. Changes in the purpose and object of an association, or in the extent of its constituency or membership, involving the amount of its capital stock, are necessarily fundamental in their character, and cannot, on general principles, be made without the express or implied consent of the members. The reason is obvious.

First, as it respects the purpose and object. This may be said to be the final cause of the association, for the sake of which it was brought into existence. To change this without the consent of the associates, would be to commit them to an enterprise which they never embraced, and would be manifestly unjust.

Secondly, as it respects the constituency, or capital and member-

ship. This is the next most important and fundamental point in the constitution of a body corporate. To change it without the consent of the stockholders, would be to make them members of an association in which they never consented to become such. It would change the relative influence, control, and profit of each member. If the directors alone could do it, they could always perpetuate their own power. Their agency does not extend to such an act unless so expressed in the charter, or subsequent enabling act; and such subsequent act, as before said, would not bind the stockholders without their acceptance of it, or assent to it in some form. Even when the additional stock is distributed to each stockholder *pro rata*, it would often work injustice, because many of the stockholders might be unable to take their respective shares, and might thus lose their relative interest and influence in the corporate concerns.

These conclusions flow naturally from the character of such associations. Of course, the associates themselves may adopt or assent to a different rule. If the charter provides that the capital stock may be increased, or that a new business may be adopted by the corporation, this is undoubtedly an authority for the corporation (that is, the stockholders) to make such a change by a stockholders' vote, in the regular way. Perhaps a subsequent ratification or assent to a change already made, would be equally effective. It is unnecessary to decide that point at this time. But if it is desired to confer such a power on the directors, so as to make their acts binding and final, it should be expressly conferred.

Where the stock expressly allowed by a charter has not been all subscribed, the power of the directors to receive subscriptions for the balance may stand on a different footing. Such an act might, perhaps, be considered as merely getting in the capital already provided for the operations and necessities of the company, and, therefore, as belonging to the orderly and proper administration of the company's affairs. Even in such case, however, prudent and fair directors would prefer to have the sanction of the stockholders to their acts. But that is not the present case, and need not be further considered.

Decree affirmed.

NOTE. — A similar conclusion as to the power of the directors, in the corporation in question, to increase the capital stock was reached in *Eidman* v. *Bowman*, 58 Ill. 444. See also *Finley Shoe Co.* v. *Kurtz*, 34 Mich. 89; *Newport Cotton Mills Co.* v. *Mims*, 103 Tenn. 465. But *cf. Mosely* v. *Koffyfontein Mines, Ltd.*, [1910] 2 Ch. 382, where this power had been expressly given to directors by amendment of the articles of association; and *Payson* v. *Withers*, 5 Biss. (U.S. C.C.) 269.

So, as to the power of the directors to decrease the capital stock. *Percy* v. *Millaudon*, 3 La. 568, 585.

So, as to the power of the directors to procure amendments to its

charter, or to assent thereto. See *Marlborough Mfg. Co.* v. *Smith*, 2 Conn. 579; *New Orleans R.R. Co.* v. *Harris*, 27 Miss. 517; *Hope Mutual Insurance Co.* v. *Beckmann*, 47 Mo. 93.

See also, as to the construction of powers given to the directors, *Blatchford* v. *Ross*, 54 Barb. (N.Y.) 42.

In the chapter on Stockholders, and the Book on the Reorganization of Corporations, *infra*, the power of the holders of a majority of the stock will be considered. In other words, if the power to do certain acts is vested in the stockholders, rather than the directors, the question remains whether such act may be authorized by the holders of a majority only of the stock of the corporation.

COMMERCIAL NATIONAL BANK *v.* WEINHARD.

192 U.S. 243. 1904.

THE Commercial National Bank of Portland was duly organized under the National Banking Act, and carried on business in the city of Portland, Oregon. It appeared that the capital of the bank had become impaired, and thereupon such proceedings were had that on December 5, 1896, the Comptroller issued the following notice to the bank:

"Treasury Department,
"Office of Comptroller of the Currency,
"Washington, D.C., Dec. 5, 1896.

"Whereas, it appears to the satisfaction of the Comptroller of the Currency that the capital stock of the Commercial National Bank, Portland, Oregon, has become impaired to an extent which makes necessary an assessment of two hundred and fifty thousand dollars ($250,000) upon the shareholders of said association to make good such deficiency:

"Now, therefore, notice is hereby given to said association, under the provisions of § 5205 of the Revised Statutes of the United States, to pay the said deficiency in its capital stock by assessment upon its shareholders, *pro rata*, for the amount of the capital stock held by each, and if such deficiency shall not be paid, and said bank shall refuse to go into liquidation, as provided by law, for three months after this notice shall have been received by it, a receiver will be appointed to close up the business of the association, according to the provisions of § 5234 of the Revised Statutes of the United States.

"In testimony whereof, I have hereunto subscribed my name and caused my seal of office to be affixed to these presents, at the Treasury Department, in the city of Washington, and District of Columbia, this 5th day of December, A.D. 1896.

"JAMES H. ECKLES,
"*Comptroller of the Currency.*

" To the Commercial National Bank, Portland, Oregon."

After receipt of this notice, upon December 12, 1896, the board of directors passed this resolution:

"*Resolved*, That in accordance with the notice served upon this association by the Comptroller of the Currency, under date of December 5, 1896, and received by this bank on the 11th day of December, 1896, an assessment is hereby levied upon the shareholders of this bank of fifty per cent or $50 per share, payable at this bank on or before March 11, 1897.

"*And, resolved*, That the cashier of this bank be, and he hereby is, authorized and instructed to serve upon each shareholder of the bank a legal notice of the above assessment by sending such notice to each shareholder's address by registered mail."

Upon December 17, 1896, notice of this assessment was served upon each of the stockholders of the bank. The defendants in error having failed to pay this assessment, on March 18, 1897, the board of directors passed a resolution directing the sale of the delinquents' stock to be made at public auction on May 5, 1897. In pursuance of this order, and on the day named, the stock was sold for the amount of the assessment. The Federal question is whether the board of directors in thus assessing and selling the stock of the defendants in error exceeded their powers under the National Banking Act; it being claimed that a valid assessment could only be made by the action of the stockholders, and that the sale by the directors upon this assessment was unlawful and amounted to a conversion of the stock.

MR. JUSTICE DAY, after making the foregoing statement delivered the opinion of the court.

This case requires the construction of § 5205 of the Revised Statutes of the United States as amended. 3 Comp. Stat. 3495. The section is as follows:

"Every association which shall have failed to pay up its capital stock, as required by law, and every association whose capital stock shall have become impaired by losses or otherwise, shall, within three months after receiving notice thereof from the Comptroller of the Currency, pay the deficiency in the capital stock, by assessment upon the shareholders *pro rata* for the amount of capital stock held by each; and the Treasurer of the United States shall withhold the interest upon all bonds held by him in trust for any such association, upon notification from the Comptroller of the Currency, until otherwise notified by him. If any such association shall fail to pay up its capital stock, and shall refuse to go into liquidation, as provided by law, for three months after receiving notice from the Comptroller, a receiver may be appointed to close up the business of the association, according to the provisions of § fifty-two hundred and thirty-four. And provided, That if any shareholder or shareholders of such bank shall neglect or refuse, after three months' notice, to

pay the assessment, as provided in this section, it shall be the duty of the board of directors to cause a sufficient amount of the capital stock of such shareholder or shareholders to be sold at public auction (after thirty days' notice shall be given by posting such notice of sale in the office of the bank, and by publishing such notice in a newspaper of the city or town in which the bank is located, or in a newspaper published nearest thereto), to make good the deficiency, and the balance, if any, shall be returned to such delinquent shareholder or shareholders."

The assessment in this case was made by the board of directors without any action of the stockholders of the association, and the defendants in error having failed to pay the same upon notice, their stock was sold as directed in the statute. It is claimed that an assessment by the directors without action of the stockholders was without authority of law and amounted to a conversion of the stock. This view was sustained in the Supreme Court of Oregon. The assessment ordered by the Comptroller was for the purpose of restoring the capital of the bank, and thus enabling it to continue its business. Ample power is conferred upon the Comptroller for this purpose. His action is in aid of other sections of the law preventing a withdrawal of the capital, or the making of dividends when losses have been sustained equal to the undivided profits. §§ 5202–5204, Rev. Stat. When the notice is received from the Comptroller by the bank under § 5205, the association has no authority to review or gainsay the necessity thereof. That question is concluded by the action of the Comptroller. The money to be raised for the continuance of the business may or may not be used in the liquidation of debts. The assessment is entirely different from that provided for in § 5151, calling upon the individual responsibility of shareholders for the payment of debts. Under the last named section the stockholder is required to pay such assessments as may be made, to meet the outstanding obligations of the bank, within the limit of an amount equal to the par value of the stock in addition to the amount invested therein. He has no election of payment, but is required to meet this liability, created by law for the benefit of creditors. Under § 5205 the amount paid is subject to the control of the board of directors in the continued operations of the bank. If the stockholders are to have a voice in making or declining to make the assessment, they may well hesitate to entrust more capital to the control of a board under whose management it has already been impaired. Certain powers are conferred by law upon the directors.

§ 5136 provides that the association shall have power —

"*Sixth.* To prescribe, by its board of directors, by-laws not inconsistent with law, regulating the manner in which its stock shall be transferred, its directors elected or appointed, its officers appointed,

its property transferred, its general business conducted, and the privileges granted to it by law exercised and enjoyed.

"*Seventh.* To exercise by its board of directors, or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this Title."

And, again, by § 5145, it is declared that the "affairs" of the corporation "shall be managed by not less than five directors."

Thus the directors are given authority to transact the usual and ordinary business of national banks. Obviously, the power conferred may be exercised in all usual transactions through the executive officers of the bank without consultation with the stockholders. In the present case the question to be dealt with is vital to the continuance of the life of the association, as only by complying with the requirement of the Comptroller in assessing a sum sufficient to make up the impaired capital of the bank can its business be continued. The shareholders by their contracts of subscription have agreed to pay in the amount of capital stock subscribed and to discharge the additional liability imposed by the statute. They have not contracted to meet assessments at the will of the directors to perpetuate the business of a possibly losing concern. It would be going far beyond the usual powers conferred upon directors to permit them to thus control the corporation. Corporate powers conferred upon a board of directors usually refer to the ordinary business transactions of the corporation. *Railway Company* v. *Allerton*, 18 Wall. 233. The assessment is required by the Comptroller, not by the directors. The association is to receive notice thereof, and action must be taken by the association to meet the requirements of the Comptroller under the statute. It is provided that if the association fail to pay up its capital stock, and refuse to go into liquidation, as provided by law, for three months after receiving notice from the Comptroller, a receiver may be appointed to close up the business of the association according to the provisions of § 5234. This important provision is entitled to much weight in determining the proper construction of the statute. The assessment may be avoided, and the amount required is not payable if the association decides to go into liquidation. Provision for voluntary liquidation is made in § 5220 wherein authority is given to liquidate upon a vote of shareholders owning two-thirds of the stock. Such liquidation does not prevent the assessment of stockholders under § 5151 for the benefit of creditors and the enforcement of the liability of the shareholders in an action by a receiver or directly by the creditors. Comp. Stat. § 5234; § 2, Act

of June 30, 1876, as amended, 3 Comp. Stat. 3509. The section referred to, § 5234, directs the appointment of a receiver to take possession of the books, records and assets of the association, to collect the debts and claims belonging to it, and, among other things, if necessary to pay the debts of the association, to enforce the individual liability of the shareholders.

We are of opinion that § 5205 is intended to and does confer upon the association the privilege of declining to make the assessment to make good the deficiency to the capital, and to elect instead to wind up the business of the bank under § 5220, which provides for voluntary liquidation by a vote of two-thirds of the shareholders. The question is, who shall exercise this privilege and determine the future of the association — is it the directors or the shareholders who have this right of decision? The origin and continuation of the association would seem to be matters in which the owners and not the managers of the bank are primarily interested. If these are privileges of the shareholders and only exercisable by them, this case presents a total lack of the exertion of the power by those upon whom it is legally conferred, as no action of the shareholders was had in the present case in making the assessment. Action upon the Comptroller's order involves extraordinary action of the association, and determines its future operations or liquidation, and is not found within the powers conferred upon the directors for the management of the business of the bank. If this were not so, then the decision of a question of such vital importance is left to the directors, who may or may not be large holders of stock. As it is a matter foreign to the powers of such boards and not conferred by statute or required for the transaction of the business of the bank, we think it was intended to be vested in the shareholders. Whether a given power is to be exercised by the directors or the shareholders depends upon its nature and the terms of the enabling act. In certain instances the law specifically requires the action of the association to be taken by its incorporators or shareholders. §§ 5133, 5134, 5136, 5143, Rev. Stat. These sections regulate matters not pertaining to the ordinary business of the bank entrusted to the directors. They deal with the exercise of those powers which concern the organization of the corporation, the amount of its capital stock and kindred matters.

In § 5205 the requirement of the Comptroller is that the association make the assessment. It is the "association" which is required to pay up the stock or go into liquidation. The payment of the assessments must come from the shareholders, and we are of the opinion that the statute contemplates action upon the alternatives presented in the statute by the association composed of its shareholders. It is true, as suggested by the learned counsel for the plaintiff in error, that it requires a two-thirds vote of the stockholders to put the bank into liquidation under § 5220; but if the

assessment is not carried, and the shareholders have not a two-thirds vote favoring liquidation, the bank is put in liquidation, and the shareholders' liability is the statutory one for the benefit of creditors, and not a venture of more capital in the enterprise with a possible stockholders' liability upon the liquidation of the bank if it shall ultimately fail. Again, if the determination of this matter is entirely left to the directors, they may, by declining to make the assessment, force a liquidation of the bank, although the shareholders — the real owners of the property — be willing to make good the impaired capital and continue the business. On the other hand, if the directors may assess to make good impaired capital, the shareholder must pay the assessment or submit to the sale of his stock. Such extraordinary powers are far beyond those required in the management of the bank's affairs or conferred in the sections of the law defining those conferred upon the directors.

HUTCHINSON *v.* GREEN.

91 Mo. 367. 1886.

BLACK J. This case is an outgrowth of *Ward* v. *Davidson*, 89 Mo. 445. By the decree rendered in that case, certain directors of the Keokuk Northern Line Packet Company were removed from office. Thereafter, and at a special election held on the seventeenth of November, 1880, pursuant to the order of the circuit court, four directors were elected to fill the unexpired term of the removed directors. There had been a disagreement of long standing between the officers and stockholders as to the management of the affairs of the company, which resulted in two parties, one known as the Davidson, or majority, party, and the other as the Gray, or minority, party; the removed directors were of the former. By cumulative voting at the special election the minority party elected a sufficient number of directors to give them a majority in the board for the time being. On the fifteenth of January, 1881, and four days before the annual election of directors, notice of which had been given, the board resolved to, and did, make a voluntary assignment of all the property of the company for the benefit of all of the creditors. At the annual election the majority party again acquired the ascendency in the board, and the plaintiffs then, for themselves and other stockholders, brought this suit against the directors who voted for the assignment. They allege that the defendants combined to destroy the property and business of the corporation, and in furtherance thereof made the assignment, and pray that the deed of assignment be set aside for the alleged fraud, for other equitable relief, and for damages.

The defendants, in making the assignment, acted in part, at

least, upon a report made by a committee appointed to examine into the affairs of the company. That report clearly enough shows that the company was unable to pay its debts in the usual course of business. But the correctness of that report was then, and is now, denied. The new board caused another report to be made, by a new committee, in which the debts are placed at $161,944.07, and in this respect the two reports are not materially different. In the last, the effects are valued at $234,229.35; thus leaving a surplus over liabilities of $72,285.62. No account is taken of capital stock, amounting to seven hundred and fifty-one thousand dollars, paid in full. The evidence as to the value of the assets is conflicting and unsatisfactory; many of the witnesses having but little knowledge of the property about which they testified. In the last report warehouses are placed at $47,197.87, and cash and bills receivable appear to be estimated at nine or ten thousand dollars. The evidence shows that the warehouses were poor affairs, scattered along the river from St. Louis to St. Paul, on property not owned by the company, and were of no greater value than eighteen thousand dollars. The bills receivable were of little value, and the company had no money on hand worthy of mention. The best steamboats, barges, and wharf-boats were mortgaged to at least forty-seven thousand dollars. Some of the boats and barges were wrecks, all were out of repair, and to put them in repair would require an outlay of forty thousand dollars. New boats and barges were required to carry on the former business of the company. The loss in business for 1880 had been sixty thousand dollars. Suits were pending against the company for large amounts. These plaintiffs and those acting in concert with them had, at the date of the assignment, suits against the company amounting to ninety thousand dollars, some commenced in foreign jurisdictions by attachment. From the evidence, as a whole, we conclude the entire property of the company was not worth more than one hundred and ninety thousand dollars under the most favorable circumstances, and as a means of raising ready money, it was not equal to the debts. In short, it is clear the corporation was insolvent, and wholly unprepared to enter the spring trade.

On the other hand, the defendants, as directors, voted for and caused the assignment to be made in opposition to the known and expressed will of a majority of the stockholders. They knew their power to control the affairs of the corporation must cease at the coming election, only four days distant. They also agreed among themselves to make the assignment before presenting the matter openly at a meeting of the directors, and then they had a deed previously prepared, with a notary public at hand to take the acknowledgment as soon as the resolution should be passed. Any inference of fraud which might be drawn from these circumstances, if they stood alone, is overcome by the other facts in the case; for the de-

fendants knew that the affairs of the corporation were growing from bad to worse. They saw the efforts of the plaintiffs, and those acting with them, to appropriate the property of the company to the payment of their debts, in disregard of the other creditors. Enough has been said to show that the Packet Company was in no condition to prosecute its business — was insolvent. Under these circumstances, the directors, having a due regard for the creditors in general, could not do otherwise than make an assignment. The alleged fraud, we conclude, is not proved, but clearly disproved.

It is further insisted that the board of directors had no power to make the assignment without the consent of the stockholders. A corporation may, like an individual, make an assignment under the statute of this state relating to voluntary assignments. *Shockley* v. *Fisher*, 75 Mo. 498. By whom, then, is the power to be exercised? By the directors, the stockholders, or by both? Where the powers of a corporation are vested in a board of directors, they may, unless restricted, do whatever the corporation might. Field on Corp., §§ 146 and 152. Now, while, by express statute, a vote of the stockholders of these corporations is essential to enable them to increase or diminish the stock, to change the business, to issue preferred stock, and to convert bonds into stocks, still, in general, article 8, of chapter 21, Revised Statutes, contemplates that the business will be conducted by a board of directors. § 930, among other things, provides that "the property or business of the corporation shall be conducted and managed by directors." Certain it is there is nothing in the statute under which this corporation was created, and by which it is governed, or in its articles of association, or bylaws, which limits or restricts the powers of the directors in the disposition of the property. The corporation then has the power to make an assignment, and that power being vested in the directors without restriction, it must follow that they, and they alone, are authorized to make it. It is the duty of the directors to care for the creditors, and when the corporation becomes crippled and unable to meet its obligations in the usual course of business, it is competent for the directors to make an assignment, and this they may do without the consent of the stockholders. This conclusion has the support of adjudications of this and other courts. *Chew* v. *Ellingwood*, 86 Mo. 260; *Dana* v. *The Bank of the United States*, 5 W. & S. (Pa.) 223; *DeCamp* v. *Alward*, 52 Ind. 473. The directors may, with propriety, consult with the stockholders, but under the circumstances just stated, and in the exercise of their best judgment, they may make the assignment even against the expressed will of the stockholders.

NOTE. — See, *accord*, *Gibson* v. *Goldthwaite*, 7 Ala. 281, 294; *Reichwald* v. *Commercial Hotel Co.*, 106 Ill. 439; *DeCamp* v. *Alward*, 52 Ind. 468, 473; *Union Bank* v. *Ellicott*, 6 G. & J. (Md.) 363;

Sargent v. *Webster*, 13 Metc. (Mass.) 497; *Rogers* v. *Pell*, 154 N.Y. 518; *Dana* v. *Bank of the U.S.*, 5 W. & S. (Pa.) 223, 245.

See, *contra*, *Bank Commissioners* v. *Bank of Brest*, Harrington (Mich.) 106.

WOOD *v.* WHELEN.

93 Ill. 153. 1879.

ONE question presented was whether the directors, without the concurrence of the stockholders, had power to mortgage the corporate property.

MR. JUSTICE SCOTT. It is undeniably the law that all business relating to the legitimate objects of the corporation, authorized by its charter, may be transacted by the directors without the sanction of the stockholders. The act under which the gas company was incorporated provides, such companies shall have power to borrow money and secure the same by deed or lien on their real or personal property or both. As borrowing money for the purpose of forwarding the objects of the corporation is among the ordinary duties of the board of directors, it follows the board may secure the same by deed or other lien. It is a part of the business transactions of the corporation which has always been regarded as within the province of the directors to perform.

In *West* v. *Madison Co. Agricultural Board*, 82 Ill. 205, the law conferred no express authority on the corporation to make a mortgage to secure money borrowed for its use, yet it was held the power to mortgage the property of the corporation is one incident to its existence and might be exercised in furtherance of the objects for which the corporation was created. There, the power to mortgage the property of the corporation to secure its indebtedness was exercised by the directors without the sanction of the stockholders, and it was regarded as binding on the corporation.

In *Miller* v. *R. and W. R.R.*, 36 Ves. 452, it was declared, a corporation may contract debts necessary for the accomplishment of the purposes of its creation and may secure the same by mortgage of any property subject to its disposal by virtue of the implied powers existing in it, where it is under no statutory restriction in that respect. Increasing the capital stock of a corporation, or other acts changing essentially its character, do not pertain to the ordinary business of the corporation, and can not, therefore, be done by the directors, but to be legal must have the sanction of the stockholders.

NOTE. — See, *accord*, *Hendee* v. *Pinkerton*, 14 All. (Mass.) 381; *Thompson* v. *Natchez Water Co.*, 68 Miss. 423; *McCurdy's Appeal*, 65 Pa. 290.

But the concurrence of stockholders to a mortgage is not infrequently expressly required. See *Alta Silver Co.* v. *Alta Placer Co.*, 78 Cal. 629.

AUTOMATIC SELF-CLEANSING FILTER CO. *v.* CUNINGHAME.

[1906] 2 Ch. 34.

MOTION.

The Automatic Self-Cleansing Filter Syndicate Company, Limited, was incorporated on June 10, 1896. The original capital of the company was 700*l.*, divided into 700 shares of 1*l.* each; but the capital had since been increased, and there had now been issued 2700 shares of 1*l.* each.

The objects of the company, as stated in clause 3 of its memorandum of association, were (*inter alia*): (*a*) To acquire from James Wilson the benefit of certain existing inventions in relation to the filtration, treatment, purification, storage, application, distribution, and use of liquids; and (*k*) to sell the undertaking of the company, or any part thereof, for such consideration as the company might deem fit, and in particular, for shares, debentures, or securities of any other company having objects altogether or in part similar to those of this company.

The articles provided as follows: —

"81. The company may by special resolution remove any director before the expiration of his period of office and appoint another qualified person in his stead. . . ."

"96. The management of the business and the control of the company shall be vested in the directors, who, in addition to the powers and authorities by these presents expressly conferred upon them, may exercise all such powers and do all such acts and things as may be exercised or done by the company, and are not hereby or by statute expressly directed or required to be exercised or done by the company in general meeting; but subject nevertheless to the provisions of the statutes and of these presents, and to such regulations, not being inconsistent with these presents, as may from time to time be made by extraordinary resolution, but no regulation shall invalidate any prior act of the directors which would have been valid if such regulation had not been made.

"97. Without prejudice to the general powers conferred by the last preceding clause, and to the other powers and authorities conferred as aforesaid, it is hereby expressly declared that the directors shall be entrusted with the following powers, namely, power —

"(1) To purchase or otherwise acquire for the company any

property, letters patent, rights or privileges which the company is authorized to acquire, at such price, and generally on such terms and conditions, as they think fit; also to sell, lease, abandon, or otherwise deal with, any property, rights, or privileges to which the company may be entitled, on such terms and conditions as they may think fit."

"(16) To enter into all such negotiations and contracts and rescind and vary all such contracts, and execute and do all such acts, deeds, and things in the name or on behalf of the company as they might consider expedient for or in relation to any of the matters aforesaid, or otherwise for the purposes of the company."

The plaintiff A. H. McDiarmid, who was the holder of 1202 shares in the plaintiff company, being desirous that the assets and undertaking of the plaintiff company should be sold, arranged terms on behalf of the company for the sale of them to a new company formed for the purpose of acquiring them, and had these terms embodied in a contract which was engrossed ready for execution by the company.

On January 2, 1906, a meeting of the shareholders of the company, convened by the directors in accordance with a requisition signed by the plaintiff McDiarmid and other shareholders in the company, was held for the purpose of considering and if thought fit passing the following resolution:

"That the company do sell the assets specified in the contract which has been produced to the meeting at the price and on the terms therein mentioned and contained and that the directors be and they are hereby directed to cause the common seal of the company to be affixed thereto within seven days and to carry the same into effect."

The meeting was adjourned until January 16, when the resolution was passed by a majority of 304 votes, 1502 votes for and 1198 votes against it. Practically the whole of the 1502 votes were given in respect of shares held by the plaintiff McDiarmid or his friends.

The directors, being of opinion that it would not be in the interests of the plaintiff company that the contract should be carried out, declined to comply with the resolution.

This was a motion by the plaintiff company and by the plaintiff McDiarmid, suing on behalf of himself and all other shareholders in the company, against the directors asking that the defendants might be ordered forthwith to affix the seal of the plaintiff company to the contract and to carry it into effect; that the defendants might be restrained by injunction until judgment or further order from dealing with or disposing of the assets of the plaintiff company intended to be comprised in the said agreement in any manner inconsistent with the terms thereof; and for the appointment of a receiver of the said assets.

The motion was heard before WARRINGTON, J., on February 23, 1906.

COLLINS, M.R. This is an appeal from a decision of WARRINGTON, J., who has been asked by the plaintiffs, Mr. McDiarmid and the company, for a declaration that the defendants, as directors of the company, are bound to carry into effect a resolution passed at a meeting of the shareholders in the company on January 16. There are a number of other incidental reliefs asked — for instance, that they be ordered to affix the seal of the company, and that they may be restrained by injunction from dealing with the assets of the company in any manner inconsistent with the agreement.

The point arises in this way. At a meeting of the company a resolution was passed by a majority — I was going to say a bare majority, but it was a majority — in favour of a sale to a purchaser, and the directors, honestly believing, as WARRINGTON, J., thought, that it was most undesirable in the interests of the company that that agreement should be carried into effect, refused to affix the seal of the company to it, or to assist in carrying out a resolution which they disapproved of; and the question is whether under the memorandum and articles of association here the directors are bound to accept, in substitution of their own view, the views contained in the resolution of the company. WARRINGTON, J., held that the majority could not impose that obligation upon the directors, and that on the true construction of the articles the directors were the persons authorized by the articles to effect this sale, and that unless the other powers given by the memorandum were invoked by a special resolution, it was impossible for a mere majority at a meeting to override the views of the directors. That depends, as WARRINGTON, J., put it, upon the construction of the articles. First of all there is no doubt that the company under its memorandum has the power in clause 3 (*k*) to sell the undertaking of the company or any part thereof. In this case there is some small exception, I believe, to that which is to be sold, but I do not think that that becomes material. We now come to clause 81 of the articles, which I think it is important to refer to in this connection. [His Lordship read the clause.] Then come the two clauses which are most material, 96 and 97, whereby the powers of the directors are defined. [His Lordship read clause 96 and clause 97 (1).] Therefore in the matters referred to in article 97 (1) the view of the directors as to the fitness of the matter is made the standard; and furthermore, by article 96 they are given in express terms the full powers which the company has, except so far as they "are not hereby or by statute expressly directed or required to be exercised or done by the company," so that the directors have absolute power to do all things other than those that are expressly required to be done by the company; and then comes the limitation on their general authority — "subject to

such regulations as may from time to time be made by extraordinary resolution." Therefore, if it is desired to alter the powers of the directors that must be done, not by a resolution carried by a majority at an ordinary meeting of the company, but by an extraordinary resolution. In these circumstances it seems to me that it is not competent for the majority of the shareholders at an ordinary meeting to affect or alter the mandate originally given to the directors, by the articles of association. It has been suggested that this is a mere question of principal and agent, and that it would be an absurd thing if a principal in appointing an agent should in effect appoint a dictator who is to manage him instead of his managing the agent. I think that that analogy does not strictly apply to this case. No doubt for some purposes directors are agents. For whom are they agents? You have, no doubt, in theory and law one entity, the company, which might be a principal, but you have to go behind that when you look to the particular position of directors. It is by the consensus of all the individuals in the company that these directors become agents and hold their rights as agents. It is not fair to say that a majority at a meeting is for the purposes of this case the principal so as to alter the mandate of the agent. The minority also must be taken into account. There are provisions by which the minority may be over-borne, but that can only be done by special machinery in the shape of special resolutions. Short of that the mandate which must be obeyed is not that of the majority — it is that of the whole entity made up of all the shareholders. If the mandate of the directors is to be altered, it can only be under the machinery of the memorandum and articles themselves. I do not think I need say more.

One argument used by WARRINGTON, J., strongly supports that view. He says in effect: "There is to be found in these articles a provision that a director can only be removed by special resolution. What is the use of that provision if the views of the directors can be overridden by a mere majority at an ordinary meeting? Practically you do not want any special power to remove directors if you can do without them and differ from their opinion and compel something other than their view to be carried into effect." That argument appears to me to confirm the view taken by the learned judge.

The cases cited do not really apply. Indeed, I do not think that Mr. Gore-Browne, who argued this case with his usual ability and fairness, looked upon them as more than presenting some analogy, and the only case which, at first sight, appeared to me at all near this case was *Isle of Wight Ry. Co.* v. *Tahourdin*, 25 Ch.D. 320; but when that is looked into, as was pointed out by COZENS-HARDY, L.J., it rests upon a different statute, a statute differing in the most essential point, namely, in the limitation of the directors' authority.

Therefore that case has no direct bearing on the case before us, and on these grounds, which in substance are the same grounds as those of the learned judge below, I am of opinion that this appeal fails.

COZENS-HARDY, L.J. I am of the same opinion. It is somewhat remarkable that in the year 1906 this interesting and important question of company law should for the first time arise for decision, and it is perhaps necessary to go back to the root principle which governs these cases under the Companies Act, 1862. It has been decided that the articles of association are a contract between the members of the company *inter se.* That was settled finally by the case of *Browne* v. *La Trinidad*, 37 Ch.D. 1, if it was not settled before. We must therefore consider what is the relevant contract these shareholders have entered into, and that contract, of course, is to be found in the memorandum and articles. I will not again read articles 96 and 97, but it seems to me that the shareholders have by their express contract mutually stipulated that their common affairs should be managed by certain directors to be appointed by the shareholders in the manner described by other articles, such directors being liable to be removed only by special resolution. If you once get a stipulation of that kind in a contract made between the parties, what right is there to interfere with the contract, apart, of course, from any misconduct on the part of the directors? There is no such misconduct in the present case. Is there any analogy which supports the case of the plaintiffs? I think not. It seems to me the analogy is all the other way. Take the case of an ordinary partnership. If in an ordinary partnership there is a stipulation in the partnership deed that the partnership business shall be managed by one of the partners, it would be plain that in the absence of misconduct, or in the absence of circumstances involving the total dissolution of the partnership, the majority of the partners would have no right to apply to the Court to restrain him or to interfere with the management of the partnership business. I would refer to what is said in Lindley on Partnership, 7th ed., p. 574: "Where, however, the partner complained of has by agreement been constituted the active managing partner, the Court will not interfere with him unless a strong case be made out against him" — that is to say, unless there is some case of fraud or misconduct to justify the interference of the Court. Nor is this doctrine limited to a case of co-partners. It is not a peculiar incident of co-partnership; it applies equally to cases of co-ownership. I think in some of the earlier cases before Lord ELDON (see *Waters* v. *Taylor*, [1808] 15 Ves. 10; [1813] 2 V. & B. 299) with reference to the co-owners of one of the theatres, he laid down the principle that when the co-owners had appointed a particular member as manager the Court would not, except in the case of misconduct, interfere with him. And why? Because it is a fallacy to say that the relation is that of simple principal and agent. The person who is managing is man-

aging for himself as well as for the others. It is not in the least a case where you have a master on the one side and a mere servant on the other. You are dealing here, as in the case of a partnership, with parties having individual rights as to which there are mutual stipulations for their common benefit, and when you once get that, it seems to me that there is no ground for saying that the mere majority can put an end to the express stipulations contained in the bargain which they have made. Still less can that be so when you find in the contract itself provisions which shew an intention that the powers conferred upon the directors can only be varied by extraordinary resolution, that is to say, by a three-fourths majority at one meeting, and that the directors themselves when appointed shall only be removed by special resolution, that is to say, by three-fourths majority at one meeting and a simple majority at a confirmatory meeting. That being so, if you once get clear of the view that the directors are mere agents of the company, I cannot see anything in principle to justify the contention that the directors are bound to comply with the votes or the resolutions of a simple majority at an ordinary meeting of the shareholders. I do not think it true to say that the directors are agents. I think it is more nearly true to say that they are in the position of managing partners appointed to fill that post by a mutual arrangement between all the shareholders. So much for principle. On principle I agree entirely with what the Master of the Rolls has said, agreeing as he does with the conclusions of WARRINGTON, J.

When we come to the authorities there is, I think, nothing even approaching to an authority in favour of the appellants' case. *Isle of Wight Ry. Co.* v. *Tahourdin*, 25 Ch.D. 320, at the utmost contained a dictum which at first sight looked in favour of appellants; but, treating it as an authority, it was an authority upon an Act which differed in a vital point from the Act which we are now considering, because although by § 90 of the Companies Clauses Act the directors have powers of management and superintendence very similar to those found in Table A, article 55, and in articles 96 and 97, that section contains these vital words: "And the exercise of all such powers shall be subject also to the control and regulation of any general meeting specially convened for the purpose." If those words had been found in the present Act of Parliament the appellants' case would have been comparatively clear. I see no ground for reading them into the Companies Act, 1862, or into the memorandum and articles of association of this company. For these reasons I think that the appeal must be dismissed.

CHARLESTOWN BOOT CO. *v.* DUNSMORE.

60 N.H. 85. 1880.

CASE. Demurrer to the declaration in which the following facts were alleged: — The plaintiffs are a manufacturing corporation having for its object a dividend of profits, and commenced business in 1871. Dunsmore was elected director in 1871 and Willard in 1873, and entered upon the discharge of their duties, and have continued so to act by virtue of successive elections until the present time. December 10, 1874, the corporation voted to choose a committee to act with the directors to close up its affairs, and chose one Osgood for such committee. Osgood tendered his services, but the defendants refused to act with him, and contracted new debts to a larger extent than allowed by law. By their negligence, debts due to the corporation to the amount of $2,161.23 have been wholly lost. By their negligence in disposing of the goods of the corporation, a loss has accrued of $3,300.40. By their neglect to sell the buildings and machinery of the corporation when they might and ought, and were urged by Osgood to sell, the same depreciated in value to the extent of $20,000.

SMITH, J. The provision of the statute is, that the business of a dividend paying corporation shall be managed by the directors. The statute reads, "The business of every such corporation shall be managed by the directors thereof, subject to the by-laws and votes of the corporation, and under their direction by such officers and agents as shall be duly appointed by the directors or by the corporation." G. L., chap. 148, § 3; Gen. Stats., chap. 134, § 3. The only limitation upon the judgment or discretion of the directors is such as the corporation by its by-laws and votes shall impose. It may define its business, its nature and extent, prescribe rules and regulations for the government of its officers and members, and determine whether its business shall be wound up or continued; but when it has thus acted, the business as thus defined and limited is to be managed by its directors, and by such officers and agents under their direction as the directors or the corporation shall appoint. The statute does not authorize a corporation to join another officer with the directors, nor compel the directors to act with one who is not a director. They are bound to use ordinary care and diligence in the care and management of the business of the corporation, and are answerable for ordinary negligence. *March* v. *Railroad*, 43 N.H. 516, 529; *Scott* v. *Depeyster*, 1 Edw. Ch. 513, 543; Ang. & Ames Corp., § 314. There is no difference in this respect between the agents of corporations and those of natural persons, unless expressly made by the charter or by-laws. *Ib.*, § 315. It would be unreasonable to hold them responsible for the management of the affairs of the corporation if com-

pelled to act with one who to a greater or less extent could control their acts. The statute not only entrusts the management of the business of the corporation to the directors, but places its other officers and agents under their direction. When a statute provides that powers granted to a corporation shall be exercised by any set of officers or any particular agents, such powers can be exercised only by such officers or agents, although they are required to be chosen by the whole corporation; and if the whole corporation attempts to exercise powers which by the charter are lodged elsewhere, its action upon the subject is void. *Insurance Co.* v. *Keyser*, 32 N.H. 313, 315. The vote choosing Osgood a committee to act with the directors in closing up the affairs of the plaintiff corporation was inoperative and void.

Demurrer sustained.

NOTE. — For further authorities tending to show that, if a corporate power is vested in the directors, the stockholders cannot exercise such power themselves, and the directors are not bound to follow their instructions, see *Curtin* v. *Salmon River Co.*, 130 Cal. 345; *Union Gold Co.* v. *Rocky Mountain Bank*, 2 Col. 565; *Stoehlke* v. *Hahn*, 158 Ill. 79; *Manufacturers' Bldg. Co.* v. *Landay*, 219 Ill. 168; *Beveridge* v. *New York Elevated R.R. Co.*, 112 N.Y. 1, 22; *Lord* v. *Equitable Life Assurance Society*, 194 N.Y. 212, 228; *Continental Securities Co.* v. *Belmont*, 206 N.Y. 7, 16; *Dana* v. *Bank of U.S.*, 5 W. & S. (Pa.) 223, 245; *Quin & Axtens, Ltd.* v. *Salmon*, [1909] A.C. 442.

But *cf. Garmany* v. *Lawton*, 124 Ga. 876; *Smith* v. *Wells Mfg. Co.*, 148 Ind. 333; *Kirwin* v. *Washington Match Co.*, 37 Wash. 285. See also *Union Pacific Ry. Co.* v. *Chicago Ry. Co.*, 163 U.S. 564, 595; *Marshall's Valve Gear Co., Ltd.* v. *Manning, Wardle & Co., Ltd.*, [1909] 1 Ch. 267; *Barron* v. *Potter*, [1914] 1 Ch. 895.

PEOPLE *ex rel.* MANICE *v.* POWELL.

201 N.Y. 194. 1911.

MANDAMUS.

The relator, who had been elected a director of the defendant Atlantic Terra Cotta Company for a term which would not expire until January, 1912, was removed prior to that time, by a majority of the directors, and this act was approved by the holders of a majority of the stock. The court held that mandamus was not the proper remedy for reinstatement, but the opinion contained a statement as to the merits.

CHASE, J. The learned justice at Special Term, in denying the

motion for a peremptory mandamus, referring to the relator, said: "As a director he was but an agent of the corporation, and the principles of the law of agency were applicable to him. If wrongfully removed before the expiration of the period for which he was elected, he is entitled to recover if damages have resulted; but he cannot insist upon being retained in a fiduciary relation towards the stockholders against the latter's wishes. The stockholders had the power to revoke the agency, though not the right."

In the reason so given for the denial of the motion we think the distinction between a person occupying an ordinary contract relation as an agent for a principal and a person elected for a specified term as a director of a private corporation was wholly overlooked.

"The board of directors of a corporation do not stand in the same relation to the corporate body which a private agent holds towards his principal. . . . In corporate bodies the powers of the board of directors are, in a very important sense, original and undelegated." *Hoyt* v. *Thompson's Executors*, 19 N.Y. 207, 216; *Beveridge* v. *N.Y. E. R.R. Co.*, 112 N.Y. 1, 22, 23.

While the ordinary rules of law relating to an agent are applicable in considering the acts of a board of directors in behalf of a corporation when dealing with third persons, the individual directors making up the board are not mere employees, but a part of an elected body of officers constituting the executive agents of the corporation. They hold such office charged with the duty to act for the corporation according to their best judgment, and in so doing they cannot be controlled in the reasonable exercise and performance of such duty. As a general rule the stockholders cannot act in relation to the ordinary business of the corporation, nor can they control the directors in the exercise of the judgment vested in them by virtue of their office.

The relation of the directors to the stockholders is essentially that of trustee and *cestui que trust.* The peculiar relation that they bear to the corporation and the owners of its stock grows out of the inability of the corporation to act except through such managing officers and agents. The corporation is the owner of the property, but the directors in the performance of their duty possess it, and act in every way as if they owned it.

This court in *Bosworth* v. *Allen*, 168 N.Y. 157, referring to directors, say: "While not technically trustees, for the title of the corporate property was in the corporation itself, they were charged with the duties and subject to the liabilities of trustees. Clothed with the power of controlling the property and managing the affairs of the corporation, without let or hindrance, as to third persons they were its agents, but as to the corporation, itself, equity holds them liable as trustees. 2 Pomeroy's Equity Jurisprudence, §§ 1061, 1063, 1088, 1097."

The relator occupied a position toward the corporation that was one of trust and responsibility. He was given power and authority to act not only substantially uncontrolled by the corporation, but he was not subject to discharge as an employee unless such right is vested in some court or body of persons by statute or in its articles of incorporation duly authorized by statute.

It would be somewhat startling to the business world if we definitely announced that the directors of a corporation were mere employees and that the stockholders of the corporation have the power to convene from time to time and remove at will any or all of the directors, although their respective terms of office have not expired.

It is and was prior to the amendment of said certificate of incorporation provided by statute that an action may be maintained against a director of a corporation to procure a judgment suspending him from exercising his office if it appear that he has abused his trust or to remove him from office upon proof or conviction of misconduct. General Corporation Law, §§ 90 and 91; former §§ 1781 and 1782 of the Code of Civil Procedure. It is provided by § 307 of said General Corporation Law that a director shall not be suspended or removed from office by a court or judge otherwise than by the final judgment of a competent court in an action brought by the attorney-general as prescribed by said § 90 of that act.

The statute providing for an action in the name of the attorney-general to suspend or remove a director is not exclusive of such reasonable and lawful charter provision relating thereto as may be included in the articles of incorporation. Without some statute or provision of the charter authorizing his removal or suspension, a director cannot be removed or suspended from office until the end of his term, at least without cause. Thompson on Corporations [2d ed.], §§ 1084, 1085, 1086; Taylor on Corporations, § 649; Cook on Corporations, § 711; Morawetz on Private Corporations, §§ 541, 542.

NOTE. — But the organization of the corporation may be such that power is reserved in the stockholders to remove a director prior to the expiration of his term of office. See *State* v. *Horan*, 22 Wash. 197; *Browne* v. *La Trinidad*, L.R. 37 Ch.D. 1.

SECTION 2.

MODE OF EXERCISING THE POWERS.

DAVENPORT *v.* PEORIA INSURANCE CO.

17 Iowa, 276. 1864.

THE agent of the defendant entered into a verbal contract of insurance upon a building belonging to plaintiff. The building was burned before any policy was issued. One ground of defense was that the defendant was not bound by this verbal contract.

COLE, J. The English rule, that a corporation cannot expressly bind itself, except by deed, unless the act establishing it authorizes it to contract in another mode, has been broken in upon, and indeed entirely overturned, as a general proposition, throughout the United States; and it is here well settled that the acts of a corporation, evidenced by vote, written or unwritten, are as completely binding upon it, and are as complete authority to its agents, as the most solemn acts done under the corporate seal.

NOTE. — In *Bank of the U.S.* v. *Dandridge*, 12 Wheat. (U.S.) 64, the court held that directorate action need not necessarily be evidenced by a written resolution. STORY, J., said (p. 80): "Assuming, then, that the directors of the parent bank were, as a board, to approve of the bond, so far as it respects the securities, in what manner is that approval to be evidenced? Without question, the directors keep a record of their proceedings as a board; and it appears by the rules and regulations of the parent bank read at the bar, that the cashier is bound 'to attend all meetings of the board, and to keep a fair and regular record of its proceedings.' If he does not keep such a record, are all such proceedings void, or is the bank at liberty to establish them by secondary evidence? The charter of the bank does not, in terms, require that such an approval shall be by writing, or entered of record. It does not, in terms, require that the proceedings of the directors shall generally be recorded, much less that all of them shall be recorded. It seems to have left these matters to the general discretion of the corporation, and of the directors; and though it obviously contemplates that there will be books kept by the corporation which will disclose the general state of its affairs, it is not a just inference that it meant that every official act of the directors should be recorded, of whatever nature it might be. And if it had, it would deserve consideration, whether

such provisions ought to be deemed conditions precedent, without which the act was void, or only directory to the officers in the performance of their duty, the omission of which might subject themselves to responsibility, and the corporation itself to the imputation of a violation of its charter."

See also *Young* v. *U.S. Mortgage & Trust Co.*, 214 N.Y. 279, 285, and cases there cited.

BALDWIN *v.* CANFIELD.

26 Minn. 43. 1879.

ONE King became the owner of all the stock of the Minneapolis Agricultural and Mechanical Association, a corporation. He pledged this stock to Baldwin and others as security for the performance of certain promises made by him. Thereafter he caused a deed of the real estate owned by said corporation to be executed by the directors of the corporation wherein the defendant Canfield was named as grantee. The execution of this deed was never authorized or directed at or by any meeting of the directors, nor was any resolution ever passed by the board of directors in reference to the execution of the deed. The deed was executed by the directors separately and at different times, wherever they happened to be, at the request of King or his attorney, for the purpose of enabling King to convey the property to Canfield. It was executed by one director in Utica, New York; by two directors in New York City; and by eight directors in Minnesota.

Canfield paid King a valuable consideration for this deed, recorded his deed, and entered into possession of the land.

The pledgees of King's stock (King not having redeemed the stock) brought this action, praying that the said deed might be cancelled.

The trial court held: "Fourth. Said deed was not the act and deed of said association, and did not convey to Canfield the legal title of the real estate purporting to be conveyed thereby"; and further held that it was void, as against the plaintiffs.

BERRY, J. The fourth conclusion is called in question by the counsel for defendant Canfield, but we have no doubt of its correctness. As we have already seen, the court below finds that, by its articles of incorporation, the government of the Minneapolis Agricultural and Mechanical Association, and the management of its affairs, was vested in the board of directors. The legal effect of this was to invest the directors with such government and management *as a board*, and not otherwise. This is in accordance with the general rule that the governing body of a corporation, as such, are agents

of the corporation only as a board, and not individually. Hence it follows that they have no authority to act, save when assembled at a board meeting. The separate action, individually, of the persons composing such governing body, is not the action of the constituted body of men clothed with corporate powers. Angell & Ames on Corporations, § 504, *et seq.*; *In re Marseilles Extension Ry. Co.*, Law Rep. 7 Ch. Ap. 161; *D'Arcy* v. *Tamar, etc., Ry. Co.*, Law Rep. 2 Exch. 158; *Schumm* v. *Seymour*, 24 N.J. Eq. 143; *First Nat. Bank* v. *Christopher*, 40 N.J. Law (11 Vroom), 435; *Junction R. Co.* v. *Reeve*, 15 Ind. 237; *Cammeyer* v. *United German Churches*, 2 Sandf. Ch. 186; *Yellow Jacket Silver Mining Co.* v. *Stevenson*, 5 Nev. 224; *Hillyer* v. *Overman Silver Mining Co.*, 6 Nev. 51; *Stoystown, etc., Turnpike Road Co.* v. *Craver*, 45 Pa. St. 386; *Edgerly* v. *Emerson*, 23 N.H. (3 Foster), 555. In Vermont a somewhat different rule is allowed, as in the *Bank of Middlebury* v. *Rutland & Washington R. Co.*, 30 Vt. 159. In that case, and perhaps others in that state, it is held that directors may bind their corporation by acting separately, if this is their usual practice in transacting the corporate business. But we think that the general rule before mentioned is the more rational one, and it is supported by the great weight of authority. From the application of this rule to the facts of this case, it follows that the fourth conclusion of law, viz., that the deed purporting to be made by the association was not the act and deed of such association, and therefore did not convey the title to the premises in question to Canfield, is correct. The directors took no action as a board with reference to the sale of the premises or the execution of any deed thereof. So far as in any way binding the corporation is concerned, their action in executing the deed was a nullity. They could not bind it by their separate and individual action. Hence it follows that the so-called deed is not only ineffectual as a conveyance of real property, but equally so as a contract to convey.

NOTE. — See, *accord*, *Alta Silver Co.* v. *Alta Placer Co.*, 78 Cal. 629, 632 (judgment creditors of a corporation successfully resisted the foreclosure of an alleged mortgage of corporate assets on the ground that the mortgage had not been authorized by the directors in meeting assembled); *Branch* v. *Augusta Glass Works*, 95 Ga. 573, 579 (a president of a corporation may not be authorized by the directors in "mere street conversation" to make calls upon stock); *Monroe Mercantile Co.* v. *Arnold*, 108 Ga. 449, 460 (similar principle as to borrowing money); *Peirce* v. *Morse-Oliver Co.*, 94 Me. 406 (action for breach of contract alleged to have been made with corporation); *Taylor* v. *R. D. Scott & Co.*, 149 Mich. 525 (corporate assets burned after the making of an alleged contract of sale, without action by directors in meeting assembled; corporation must stand loss); *Brinkerhoff Zinc Co.* v. *Boyd*, 192 Mo. 597, 613; *De-*

marest v. *Spiral Riveted Tube Co.*, 71 N.J.L. 14; *Holcombe* v. *Trenton White City Co.*, 80 N.J. Eq. 122, 132; *People's Bank* v. *St. Anthony's Church*, 109 N.Y. 512; *State* v. *People's Association*, 42 Ohio, 579; *In re Haycraft Gold Mining Co.*, [1900] 2 Ch. 230.

An express provision in the certificate of incorporation that "any resolution, in writing, signed by all the members of the board of directors . . . shall be and constitute action by such board . . . with the same force and effect as if the same had been duly passed by the same vote at a duly called meeting," is invalid. *Audenried* v. *East Coast Milling Co.*, 68 N.J. Eq. 450. The court said (p. 468): "The proposition that the stockholders, in assenting to this provision in the articles of association, waived the advantage and protection they would enjoy under the common law and our Corporation act, does not meet the case. Stockholders may waive an advantage, but they cannot by waiver ordain a method of corporate action which the law does not recognize, nor dispense with the aid of a board of directors as a means of corporate action. Such a course is not sanctioned by our law and is inconsistent with the twelfth section of our act, which requires that 'the business of every corporation shall be managed by its directors.' But we ought not to confine the consideration of this question to the relationship existing between the stockholders and the directors. The business of the state is to a large extent carried on by corporations, and their transactions directly and vitally affect the interests of all the people. In committing the transaction of business so generally to corporations, the legislature may be presumed to have provided for and recognized deliberative meetings of directors as a safeguard to the public interest, which presumption ought not to be overthrown by a forced construction of the act. The fundamental idea of a business corporation involves an advantage coming from the aggregation of wisdom, knowledge and business foresight which results from bringing a large number of stockholders and directors into a common enterprise. It is their knowledge and wisdom combined, acting as a unit, that gives efficiency and safety to the corporate management."

A fortiori, corporate action is not to be predicated upon the assent, given separately, of enough of the directors to constitute a quorum. *Herrington* v. *District Township*, 47 Iowa, 11 (action to recover for services in teaching school. "The question is here presented whether a corporation whose business is transacted by a board of directors can be bound by the assent of a majority of the directors to a contract, expressed otherwise than at a duly convened meeting. We are of opinion that it cannot. While it is true that a majority of the board will govern in the absence of a provision by statute, or in the articles of incorporation, requiring the concurrence of a greater number, yet their determination is valid only after the minority have had an opportunity to be heard. A board must act as

a unit, and in the manner prescribed"); *New Orleans Co.* v. *Lawson*, 11 La. 34; *Hamlin* v. *Brass Co.*, 68 N.H. 292 (alleged discharge of superintendent not a corporate act); *Bank* v. *Lumber Co.*, 116 N.C. 827; *Doernbecher* v. *Columbia City Co.*, 21 Or. 573; *Stoystown Co.* v. *Craver*, 45 Pa. 386; *Singer* v. *Salt Lake Co.*, 17 Utah, 143, 160; *Limer* v. *Traders Co.*, 44 W.Va. 175, 180; *Leonard* v. *Lent*, 43 Wis. 83; *D'Arcy* v. *The Tamar Co.*, L.R. 2 Exch. 158.

But see, *contra*, *Longmont Supply Ditch Co.* v. *Coffman*, 11 Colo. 551; *National Bank* v. *Sandford Fork Co.*, 157 Ind. 10, 17; *Buck* v. *Troy Aqueduct Co.*, 76 Vt. 75.

There may be circumstances justifying the holding of a meeting of the board of directors without notice to all the directors. See *Stafford Springs Co.* v. *Middle River Co.*, 80 Conn. 37, 41.

FINLEY SHOE & LEATHER CO. *v.* KURTZ.

34 Mich. 89. 1876.

COOLEY, CH.J. The plaintiff in error is a manufacturing corporation doing business in the city of Detroit. It was organized under the general law providing for the organization of such corporations, and by its articles its capital stock is thirty thousand dollars, which may be increased to one hundred and fifty thousand dollars. Kurtz was in the employ of the corporation and loaned money to it. For this he proposed to take stock, and also for a portion of what he earned by his services. The corporators were only three in number, and one of them informed Kurtz that he had conferred with the others and it was agreed that Kurtz should have stock for what was owing him. The sum was afterwards credited him on the corporate books as payment on stock, but without his direction. In the corporate reports subsequently made to the secretary of state, Kurtz was set down as a stockholder, but of this he had no knowledge. Afterwards Kurtz was discharged from the service of the corporation, and he then brought suit for what was credited to him, refusing to take stock therefor. It appears that the three original stockholders held the whole thirty thousand dollars of stock; that the corporation never took steps to increase the capital to any larger sum, and that no individual stockholder offered to assign to Kurtz any of his stock.

The defense to Kurtz's suit is, that what was due him has by his consent been applied on stock, and that he is entitled to stock therefor and nothing else. To make good this defense the corporation must have shown, *first*, that it had stock to give Kurtz; and, *second*, that there was an agreement on their part that he should have it, and on his part that he would take it.

That the corporation might have had the stock to give Kurtz is

undoubted. All that was necessary was that the corporation should increase its capital stock in the manner provided by law, that is to say, by vote of the stockholders at a meeting called for that purpose. Comp. L., § 2841. Probably by corporate action it might in advance agree to make such increase, and receive money for stock to be issued when the increase should be declared. But it is not very clear that the officers of the company could take action of that nature which would bind the corporators; for if they could, a meeting of the stockholders for the purpose would be a mere ceremony to do that which they could not refuse to do. It certainly could not be within the implied powers of any corporate officer to obligate the corporation to any such increase, and thus indirectly do what the law permits to be done only by the body of corporators specially convened for the purpose.

Taking the case as it stands on the record, it is very manifest that the corporation was never placed under obligation to give Kurtz the stock. Assuming that all the stockholders had severally agreed to it, this agreement bound no one, and might have been repudiated at any corporate meeting. Where joint action is required by law, individual action is of no avail, and at most only puts the individuals under honorary obligations of which the law can take no notice. Suppose Kurtz had demanded the stock when he was discharged, it is clear that the corporation would have had none to give him. Suppose he had sued the corporation for refusal to deliver, where would he have discovered the elements of a contract to that effect? Certainly not in a report to which he was no party, and which was made without his consent or knowledge. Certainly not in the assurances of individual stockholders, when these, so far from binding the corporation, would not even bind themselves individually. The conclusion is inevitable that Kurtz must have failed in such an action, and if so, the corporation must fail in this defense. There can be no contract without mutuality, and a corporation can only be bound by corporate action, and that we look for in vain in this record.

The judgment must be affirmed, with costs.

NOTE. — See, *accord*, *Duke* v. *Markham*, 105 N.C. 131.

HOISTING MACHINERY CO. *v.* GOELLER IRON WORKS.

84 N.J.L. 504. 1913.

TRENCHARD, J. This suit was brought to recover a commission of five per cent. for the services of the plaintiff, a mechanical engineering company, in procuring for the defendant, who was engaged

in the business of constructing and erecting iron work, a contract with the Harwood Electrical Company.

The plaintiff's action was based, primarily, upon the following letter purporting to be from the defendant: —

NEWARK, N.J., Aug. 23, 1909.

Hoisting Machinery Co.,
New York City:

DEAR SIRS — We have to-day mailed estimates to the Harwood Mfg. Co. for structure for coal and ash conveyor of which we enclose copy.

We hereby agree to give you 5 per cent. of the amount for your commission, same to be paid to you on receipt of payment for this work.

Respectfully yours,
THE GOELLER IRON WORKS,
JOHN GOELLER,
Sec'y.

The case was tried before the judge without a jury, and he found the following matters of fact: "That (1) the plaintiff, in July, 1909, received an inquiry from a client concerning the erection of a piece of conveying machinery to be constructed of iron or steel; that (2) after preparing plans, the plaintiff sent the plans to the defendant for an estimate; that (3) as a result of the sending of the plans by the plaintiff to the defendant, an estimate was made by the defendant to the Harwood Electrical Company for the erection of the machinery for which plans had been sent by the plaintiff to the defendant, and the defendant agreed to pay the plaintiff a commission of five per cent. of the amount of money which the defendant should receive if the estimate was accepted, to be paid to the plaintiff on receipt of payment by the defendant for the work; that (4) after August 23d, 1909, the estimate was accepted and defendant entered into a contract with the Harwood Electrical Company, which included all the work called for in the estimate, and more besides; that (5) the defendant received $8,342.28 for work done by it under said contract."

Judgment was entered for the plaintiff for the sum of $462.98, being five per cent. of $8,342.28, with interest, and the defendant appealed. . . .

It is next contended that the judge erred in refusing to nonsuit the plaintiff. Not so. The motion was based upon two grounds — *first*, that there was no corporate action by the defendant company, agreeing to pay commission to the plaintiff, and *secondly*, that no authority was shown in the secretary of the defendant company to make such contract.

The rules as to nonsuits are the same, and have the same application, when the trial is by the court as when it is by a jury. *Weston Company* v. *Benecke*, 53 Vroom, 445.

And the rule is well settled that where, as in this case, the evidence tends to show that, in the general course of the business of an incorporated business company, the directors or managers have permitted an officer to assume the direction and control of the business, and have held him out to the public as its general agent, his authority to act for the company in a particular transaction may be implied from the manner in which he has been permitted by the directors or managers to transact business. *Fifth Ward Savings Bank* v. *First National Bank*, 19 Vroom, 513.

NOTE. — See, *accord*, *Winer* v. *Bank*, 89 Ark. 435, 446; *York* v. *Mathis*, 103 Me. 67, where the court said (p. 78): "A corporation must act and speak through its officers and authorized agents and it is entirely competent for a board of directors to establish a mutual understanding that one of their number shall be the active agent of the board in the management of the property and the conduct of the business affairs of the corporation. It is not necessary that such an understanding should be created by a formal vote passed at a formal meeting or proved by a formal record. It may be inferred from the situation and conduct of the parties. A director 'may acquire the power to bind the corporation by the habit of acting with the assent and acquiescence of the board,' and so his unauthorized acts 'may be confirmed by the approbation and acquiescence of the board.' It is true that in either case it is the board that acts or acquiesces and not the directors as individuals, but subsequent ratification as well as previous authority or acquiescence may be shown by circumstances and conduct."

See also *Pottsville Bank* v. *Water Co.*, 211 Pa. 566 (stockholders).

JOURDAN *v.* LONG ISLAND R.R. CO.

115 N.Y. 380. 1889.

DANFORTH, J. This action was begun in November, 1884, to recover damages from the Long Island Railroad Company for breach of a written contract purporting to have been made on the 31st day of May, 1879, between the "Brooklyn, Flatbush and Coney Island Railway Company," of the first part, "Thomas R. Sharp, as receiver," of the property, etc., of the Long Island Railroad Company, of the second part, the "Long Island Railroad Company," of the third part, and the "Atlantic Avenue Railroad Company of Brooklyn," of the fourth part. It was, by its terms, to continue for a period of five years from its date. The Brooklyn, Flatbush and Coney Island Railroad Company and the Long Island Railroad Company were severally the owners and operators of railways, and,

so far as is material to any question calling for our discussion, the terms of the contract were such that the first named company was required to extend and maintain its track at its own expense, but in a manner satisfactory to the other company, from its then terminus at Bedford station, so that it should connect with the tracks of the Long Island Railroad Company on Atlantic avenue, and thus form continuous lines of double track railroad between the depots of that company at Flatbush avenue and East New York, and the depot of the Brooklyn, Flatbush and Coney Island Railway Company at Brighton Beach on Coney Island, and as it pleased, run trains over the line so made continuous between Flatbush avenue and Brighton Beach. The Long Island Railroad Company and Sharp, its receiver, agreed to furnish it with "all necessary depot facilities for its trains and passengers" at Flatbush avenue, and through its agents sell the tickets at that place; and the party of the first part agreed to pay to the Long Island Railroad Company, in compensation "for the use of its tracks, the sale of its tickets and for depot facilities, twenty per cent of all moneys earned by it for the transportation of passengers between Flatbush avenue and any and all points on the line of the party of the first part, south of Bedford station." Similar rights were secured to the Long Island Railroad over the continuous line, and a described portion of the plaintiff's tracks and depot facilities secured to it at Brighton Beach, and for this use and these facilities the defendant agreed to pay thirty-three and one third per cent of all moneys earned by it for the transportation of passengers between Long Island City and Brighton Beach, and thirty-five per cent of all moneys earned by it for the transportation of passengers between Bushwick and Brighton Beach, and certain other proportion for passengers between other stations.

It was also provided that the party of the first part (the B.F. & C. Co.) shall begin to run trains from Flatbush avenue to Brighton Beach, and the party of the second part (the L.I. R.R. Co.) from Long Island City to Brighton Beach, on or before the fifteenth day of June in each year, and shall run every day thereafter, Sundays excepted, until the first day of October, at least twelve trains each way. Other payments were provided for, growing out of these arrangements for the use of each other's track, and it was agreed that full statements of the business done under the agreement should be given to each party by the other at stated intervals, and that the books of the several companies should be open to the other's inspection. The receivership of the Long Island Railroad terminated in October, 1881, and the road was restored to the company. The questions at issue concern only the plaintiff, who represents the party of the first part in the agreement, and the defendant, the Long Island Railroad Company. The alleged breach consisted, in substance, of the failure of the defendant's receiver, and its own subsequent refusal

to run the trains of the Long Island Railroad Company over a certain portion of the plaintiff's road, as provided by the contract, and their omission to furnish depot facilities as also therein provided. Issue was taken upon these allegations and a trial had. At the close of the evidence the defendant's counsel moved the trial judge to dismiss the complaint on the ground that the evidence was insufficient to show a contract between the plaintiff and defendant. The motion was denied and the case submitted to the jury upon both issues. Their verdict was for the plaintiff, and it has been approved both by the trial judge, in denying the defendant's motion for a new trial, and by the General Term in affirming the order and the judgment entered upon the verdict. The defendant's contention is that the contract was not binding upon it. It was, as is conceded, executed in the name of the corporation by its president and secretary. It was sealed with its corporate seal, affixed by its proper officers. It was, therefore, presumptively valid and was binding upon the corporation until evidence to the contrary should be produced. If the seal was obtained fraudulently or the officers acted without authority either in executing the contract in their official character, or in affixing the seal, it lay with the defendant to establish those facts. The evidence adduced for that purpose was from the secretary. He testified that the contract was drafted in pursuance of negotiations between the two companies, and the draft was in "his office." An emergency arose which called for its completion, and he, after consulting with Sharp, the president, with him, signed, sealed and delivered it. "I expected," he says, "to get a ratification." Both of these officers were also directors, and the witness says: "I intended to call the board's attention to it, but forgot it."

The court committed no error in refusing to dismiss the complaint or in refusing to charge the jury that the contract was not binding upon the company. Sharp, the president, was not examined upon that point, and whether the officers of the company did, in fact, exceed their authority, might have been, under the evidence, a question for the jury. No request was made to submit it. There was, however, abundant and conclusive evidence that the contract was adopted and ratified by the defendant in its corporate capacity. It was, as the secretary and counsel of the defendant testified, drafted in pursuance of negotiations had between the parties. It was acted upon by the defendant in the management of its business; for one year the defendant compiled with its terms and received for the entire period the benefit of a faithful performance on the part of the other contracting party. It necessarily affected the running of plaintiff's trains and the management of the business for which it was incorporated. As summarized by the learned counsel for the appellant, "it gave rights to another corporation" (the plaintiff) "to use the tracks and depots of the Long Island Railroad

Company, and provided for a division of earnings," and it is impossible to suppose that these things were suffered or enjoyed without full corporate knowledge of the contract obligations by which they were provided for. Moreover, the defendant received a pecuniary benefit under the contract, upon the assumption that the contract was valid. If they intended to disavow it, it was their duty to be active in so doing and not remain willfully passive, in order to profit by the omission or mistake on the part of their own officers, and which they might have prevented. The appellant argues that the objects of the parties might have been attained by two contracts as well as by one, and, therefore, that the defendant is at liberty to adopt so much as makes for its benefit and reject the rest. It may be that two separate contracts could have been framed in such manner as to meet the views of the parties, and in that case one have been rejected at the party's risk and the other performed, but only one was prepared, and that recites that "in consideration of the mutual covenants and agreements" therein "contained," the parties have agreed and do agree as therein expressed. The provisions are reciprocal. One party cannot say "I have got all I bargained for," and without liability repudiate the mutual obligation which enabled it to do so, and formed the consideration of the bargain. One promise was the consideration for the other, and together they constituted a binding agreement. If, in fact, the formal execution of the contract was unauthorized, it is plain the agreement was one the company had power to make, one which they intended to make, supposed they had made, and which, with knowledge, or full means of knowledge of its terms, they acquiesced in and ratified by acting under it, so long as it was profitable, and refusing to do so only when it seemed otherwise, but receiving the benefit of it at all times. It is now argued that the question of ratification should have been passed upon by the jury. It is a sufficient answer that no request was made to have it submitted to them, but it may be further said that upon that point the evidence was all one way and conclusive in the highest degree. We find no legal merit in either of these points. The other questions raised by the appellant have been examined, and so far as they require particular observation the remarks of the General Term are sufficient. We find none which requires other discussion. Upon the assumption that the contract bound the defendant, the plaintiff's way was clear and his right to a recovery certain. The reasonableness of the amount actually given to him is not for us to determine.

Judgment affirmed.

NOTE. — See, *accord*, *Blood* v. *La Serena Co.*, 134 Cal. 361, 366; *Beach* v. *Miller*, 130 Ill. 162, 174; *Tryon* v. *White Co.*, 62 Conn. 161; *Baker* v. *Harpster*, 42 Kan. 511; *Union Trust Co.* v. *Electric Park*

Co., 163 Mich. 687; *Presbyterian Board* v. *Gilbee*, 212 Pa. 310; *Bank of Middlebury* v. *Rutland R.R. Co.*, 30 Vt. 159; *Murray* v. *Beal*, 23 Utah, 548; *King* v. *West Coast Grocery Co.*, 72 Wash. 132.

Cf. People's National Bank v. *New England Home*, 209 Mass. 48.

SHERMAN *v.* FITCH.

98 Mass. 59. 1867.

BILL IN EQUITY by assignees of the Northampton Street Sugar Refinery, an insolvent corporation, praying for a decree that a recorded mortgage of personal property, held forth by the respondent as having been made to him by the corporation, might be declared void. The mortgage (dated January 19, 1865) purported, by the language of the grant, covenants, and condition, to be the mortgage of the corporation. It was signed "George R. Sampson, President of Northampton Street Sugar Refinery." [Seal.]

After a demurrer had been overruled, the respondent filed an answer putting in issue the validity of the mortgage as a mortgage of the corporation. The case was reserved for determination by the full court on agreed facts, which were, in part, as follows: —

For some time prior to January 19, 1865, the respondent had been, and then was, selling agent of the corporation, which owed him about eighteen thousand dollars, to secure the payment of which by the corporation, George R. Sampson, who was president and a director, and was also manager of the manufacturing department, executed and delivered to him the instrument in question. At that date there were four directors (who were the principal stockholders): Sampson; his son; a nephew; and one Tappan, who was in Europe. That was the full number of the board required by the by-laws, which also provided that "the board of directors shall manage and control the business, property, and affairs of the corporation." The records of the corporation contained no express vote of either directors or stockholders authorizing the execution and delivery to the respondent of a mortgage on the corporate property; but the execution and delivery of the instrument was known to all the directors except Tappan, at the time thereof, "and was approved by them, provided their neglect to make any objection to the same can be construed as an approval."

WELLS, J. The remaining consideration relates to the authority of Sampson to execute the mortgage in behalf of the corporation. It is not necessary that the authority should be given by a formal vote. Such an act by the president and general manager of the business of the corporation, with the knowledge and concurrence of the directors, or with their subsequent and long-continued acqui-

escence, may properly be regarded as the act of the corporation. Authority in the agent of a corporation may be inferred from the conduct of its officers, or from their knowledge and neglect to make objection, as well as in the case of individuals. *Emmons* v. *Providence Hat Manufacturing Co.*, 12 Mass. 237; *Melledge* v. *Boston Iron Co.*, 5 Cush. 158; *Lester* v. *Webb*, 1 Allen, 34. The absence of one of the directors in Europe could not deprive the corporation of the capacity to act and bind itself by the acts of the officers in actual charge of its affairs.

If the validity of the mortgage were to depend entirely upon subsequent ratification, such ratification would be effective notwithstanding the recording of the mortgage. No new record would be necessary. The ratification relates back.

NOTE. — See, *accord, Union Pacific Ry. Co.* v. *Chicago Ry. Co.*, 163 U.S. 564, 596.

See also *Morisette* v. *Howard*, 62 Kan. 463 (knowledge and acquiescence by stockholders).

The student should consider whether it is consistent to hold that corporate authorization may not be predicated upon the assent of the directors, given severally, that an act shall be done in behalf of the corporation; and also to hold that corporate ratification may be predicated upon the fact that the directors severally knew that an act had been done in behalf of the corporation, and that they did nothing to express their disapproval.

BOOK IV.

LIABILITY FOR TORTS AND CRIMES.

CHAPTER I.

IN GENERAL.[1]

BLACKSTONE, COMMENTARIES.

Book I, pp. 476, 477.

There are also certain privileges and disabilities that attend an aggregate corporation. . . . It can neither maintain, or be made defendant to, an action of battery or such like personal injuries: for a corporation can neither beat nor be beaten, in its body politic. A corporation cannot commit treason, or felony, or other crime, in its corporate capacity: though its members may in their distinct individual capacities. Neither is it capable of suffering a traitor's or a felon's punishment, for it is not liable to corporal penalties, nor to attainder, forfeiture or corruption of blood. It cannot be executor or administrator, or perform any personal duties; for it cannot take an oath for the due execution of the office. It cannot be seised of lands to the use of another; for such kind of confidence is foreign to the end of its institution. Neither can it be committed to prison, for its existence being ideal, no man can apprehend or arrest it. . . . Neither can a corporation be excommunicated; for it has no soul, as is gravely observed by Sir Edward Coke.

CHESTNUT HILL TURNPIKE CO. *v.* RUTTER.

4 S. & R. (Pa.) 6. 1818.

The question presented was whether a corporation, authorized to build a turnpike, was liable for damages done to property of the plaintiff, by water thrown upon the plaintiff's land by reason of structures erected in building the turnpike. A judgment for the plaintiff was affirmed.

[1] Torts committed in the course of *ultra vires* undertakings are considered in the Book on Unauthorized Corporate Action.

TILGHMAN, C.J. A very refined argument is brought forward, to prove that a corporation cannot be guilty of a tort. A corporation, say the defendant's counsel, is a mere creature of law, and can act only as authorized by its charter. But the charter does not authorize it to do wrong, and therefore it can do no wrong. The argument is fallacious in its principles, and mischievous in its consequences, as it tends to introduce actual wrongs and ideal remedies; for a turnpike company may do great injury, by means of laborers who have no property to answer the damages recovered against them. It is much more reasonable to say, that when a corporation is authorized by law to make a road, if any injury is done in the course of making that road by the persons employed under its authority, it shall be responsible, in the same manner that an individual is responsible for the actions of his servants, touching his business. The act of the agent is the act of the principal.

NOTE. — All corporate action must, in the nature of things, be vicarious. If a corporation appoints an agent to carry on an *intra vires* undertaking, it is submitted that the corporation should be required to respond for the act of that agent in any case where the master, if a human being, would be required to respond.

The authorities, *accord*, are very numerous.

See *Baltimore R.R. Co.* v. *Fifth Baptist Church*, 108 U.S. 317 (maintaining a nuisance); *Brokaw* v. *New Jersey R.R. Co.*, 32 N.J.L. 328 (assault and battery); *Savannah Electric Co.* v. *Wheeler*, 128 Ga. 550 (conductor of a street railway company caused the death of A by firing a pistol); *Waterman Co.* v. *Modern Pen Co.*, 235 U.S. 88, 94 (unfair competition); *Carr* v. *National Bank*, 167 N.Y. 375 (false representations); *Peebles* v. *Patapsco Co.*, 77 N.C. 233 (deceit); *Baltimore Ry. Co.* v. *Ennalls*, 108 Md. 75 (false imprisonment); *Fetty* v. *Loan Co.*, 70 W.Va. 688 (malicious prosecution); *Sun Life Assurance Co.* v. *Bailey*, 101 Va. 443 (libel); *Empire Cream Co.* v. *De Laval Dairy Co.*, 75 N.J.L. 207 (slander); *Hypes* v. *Southern Ry. Co.*, 82 S.C. 315; *Aberthau Construction Co.* v. *Cameron*, 194 Mass. 208 (conspiracy).

But as to slander, see *Singer Mfg. Co.* v. *Taylor*, 150 Ala. 574; *Waters-Pierce Oil Co.* v. *Bridwell*, 103 Ark. 345; *Stewart Dry Goods Co.* v. *Heuchtker*, 148 Ky. 228; *Kane* v. *Boston Mutual Co.*, 200 Mass. 265; *Redditt* v. *Mfg. Co.*, 124 N.C. 100.

As to the exemption from liability of a charitable corporation see *Hearns* v. *Waterbury Hospital*, 66 Conn. 98. *Cf. Hordern* v. *Salvation Army*, 199 N.Y. 233.

As to the exemption from liability of a corporation which is a servant of the crown, see *Roper* v. *Public Works Commissioners*, [1915] 1 K.B. 45.

As to the limits, in the nature of things, to vicarious action, the

student should compare *Matter of Co-Operative Law Co.*, 198 N.Y. 479, with *Willmott* v. *London Road Car Co., Ltd.*, [1910] 2 Ch. 525.

In *Matter of Co-Operative Law Co.*, the court held that a corporation cannot practice law, saying (p. 483): "The practice of law is not a business open to all, but a personal right, limited to a few persons of good moral character, with special qualifications ascertained and certified after a long course of study, both general and professional, and a thorough examination by a state board appointed for the purpose. The right to practice law is in the nature of a franchise from the state conferred only for merit. It cannot be assigned or inherited but must be earned by hard study and good conduct. It is attested by a certificate of the Supreme Court and is protected by registration. No one can practice law unless he has taken an oath of office and has become an officer of the court, subject to its discipline, liable to punishment for contempt in violating his duties as such, and to suspension or removal. It is not a lawful business except for members of the bar who have complied with all the conditions required by statute and the rules of the courts. As these conditions cannot be performed by a corporation, it follows that the practice of law is not a lawful business for a corporation to engage in."

But in *Willmott* v. *London Road Car Co., Ltd.*, it was held that a limited company was capable of being "a respectable and responsible person." A lessee covenanted to use the demised premises for the business of a jobmaster and livery stable keeper, and not to assign or underlet without the written consent of the lessor, which consent was not to be withheld in respect of a respectable and responsible person. COZENS-HARDY, M.R., said (p. 531): "Suppose the words had simply been that consent should not be withheld in the case of a responsible person, I cannot bring myself to doubt that in that case a company which was admitted to be responsible in the sense of being able to discharge all obligations in respect of rent and covenants under the lease would be a responsible person within the meaning of that covenant, and therefore a person with respect to whom consent could not be refused. But then it is said, and this is the point which alone has given me difficulty in this case, 'Can it be said that a corporation can be respectable? Does not the addition of that word "respectable" compel you to say that in this case the word "person" must be limited to an individual, a human personality, a person who is capable of acts moral or immoral?' In my opinion that is not so. I think the ordinary use of language justifies you in saying that a company is a respectable company. We all use that language habitually. We talk of a respectable insurance company, or a respectable bank, and in that case we refer to the mode in which the company or the bank conducts its business. But I think we are not without assistance from authority

which is absolutely binding on us. A limited company or a company whether limited or not can maintain an action of libel for an injury to its reputation without proving any special damage. A company can have a reputation which is not the reputation of the individual directors, but the reputation of the company, the reputation which the company itself and itself alone can protect by means of an action of libel."

UNITED STATES *v.* JOHN KELSO CO.

86 Fed. 304. 1898.

De Haven, District Judge. On October 9, 1897, there was filed in this court by the United States district attorney for this district, an information charging the defendant, a corporation, with the violation of "An act relating to the limitation of the hours of daily service of laborers and mechanics employed upon the public works of the United States and of the District of Columbia," approved August 1, 1892 (2 Supp. Rev. St. p. 62). Upon the filing of this information, the court, upon motion of the district attorney, directed that a summons in the general form prescribed by § 1390 of the Penal Code of this State, be served upon said corporation, and accordingly on said date a summons was issued, directing the defendant to appear before the judge of said court in the court room of the United States District Court for this district on the 21st day of October, 1897, to answer the charge contained in the information. The summons stated generally the nature of the charge, and for a more complete statement of such offense referred to the information on file. On the day named in said summons for its appearance, the defendant corporation appeared specially by its attorney, and moved to quash the summons, and to set aside the service thereof, upon grounds hereinafter stated. Upon the argument of this motion, it was claimed in behalf of the defendant: First, that the act of Congress above referred to does not apply to corporations, because the intention is a necessary element of the crime therein defined, and a corporation as such is incapable of entertaining a criminal intention. . . . It will be seen that the first objection goes directly to the sufficiency of the information, and presents precisely the same question as would a general demurrer, attacking the information on the ground of an alleged failure to charge the defendant with the commission of a public offense. This objection is one which would not ordinarily be considered upon a motion like that now before the court, when the party making the objection refuses to acknowledge the jurisdiction of the court, or to make any other than a special appearance for the purpose of attacking its jurisdiction;

but, in view of the conclusion which I have reached upon the second point urged by the defendant, it becomes necessary for me to determine whether the act of Congress above referred to is applicable to a corporation, and whether a corporation can be guilty of the crime of violating the provisions of said act. § 1 of that act makes it unlawful for a contractor or subcontractor upon any of the public works of the United States, whose duty it shall be to employ, direct, or control the services of laborers or mechanics upon such public works, "to require or permit any such laborer or mechanic to work more than eight hours in any calendar day except in cases of extraordinary emergency." And § 2 of the act provides that ". . . any contractor whose duty it shall be to employ, direct, or control any laborer or mechanic employed upon any public works of the United States . . . who shall intentionally violate any provision of this act, shall be deemed guilty of a misdemeanor, and for each and every offense shall upon conviction be punished by a fine not to exceed one thousand dollars or by imprisonment for not more than six months, or by both such fine and imprisonment, in the discretion of the court having jurisdiction thereof." It will be observed that by the express language of this statute there must be an intentional violation of its provisions, in order to constitute the offense which the statute defines. In view of this express declaration, it is claimed in behalf of defendant that the act is not applicable to corporations, because it is not possible for a corporation to commit the crime described in the statute. The argument advanced to sustain this position is, in substance, this: That a corporation is only an artificial creation, without animate body or mind, and therefore, from its very nature, incapable of entertaining the specific intention which, by the statute, is made an essential element of the crime therein defined. The case of *State* v. *Great Works M. & M. Co.*, 20 Me. 41, supports the proposition that a corporation is not amenable to prosecution for a positive act of misfeasance, involving a specific intention to do an unlawful act, and it must be conceded there are to be found dicta in many other cases to the same effect. In a general sense, it may be said that no crime can be committed without a joint operation of act and intention. In many crimes, however, the only intention required is an intention to do the prohibited act, — that is to say, the crime is complete when the prohibited act has been intentionally done; and the more recent and better considered cases hold that a corporation may be charged with an offense which only involves this kind of intention, and may be properly convicted when, in its corporate capacity, and by direction of those controlling its corporate action, it does the prohibited act. In such a case the intention of its directors that the prohibited act should be done is imputed to the corporation itself. *State* v. *Morris E. R. Co.*, 23 N.J. Law, 360; *Reg.* v. *Great*

North of England Ry. Co., 58 E.C.L. 315; *Com.* v. *Proprietors of New Bedford Bridge*, 2 Gray, 339. See, also, *State* v. *Baltimore & O. R. Co.*, 15 W.Va. 380. That a corporation may be liable civilly for that class of torts in which a specific malicious intention is an essential element is not disputed at this day. Thus an action for malicious prosecution will lie against a banking corporation. *Reed* v. *Bank*, 130 Mass. 434; *Goodspeed* v. *Bank*, 22 Conn. 530. An action will lie also against a corporation for a malicious libel. *Railroad Co.* v. *Quigley*, 21 How. 202; *Maynard* v. *Insurance Co.*, 34 Cal. 48. The opinion in the latter case, delivered by CURREY, C.J., is an able exposition of the law relating to the liability of corporations for malicious libel, and in the course of which that learned judge, in answer to the contention that corporations are mere legal entities existing only in abstract contemplation, utterly incapable of malevolence, and without power to will good or evil, said: "The directors are the chosen representatives of the corporation, and constitute, as already observed, to all purposes of dealing with others, the corporation. What they do within the scope of the objects and purposes of the corporation, the corporation does. If they do any injury to another, even though it necessarily involves in its commission a malicious intent, the corporation must be deemed by imputation to be guilty of the wrong, and answerable for it, as an individual would be in such case."

The rules of evidence in relation to the manner of proving the fact of intention are necessarily the same in a criminal as in a civil case, and the same evidence which in a civil case would be sufficient to prove a specific or malicious intention upon the part of a corporation defendant would be sufficient to show a like intention upon the part of a corporation charged criminally with the doing of an act prohibited by the law. Of course, there are certain crimes of which a corporation cannot be guilty; as, for instance, bigamy, perjury, rape, murder, and other offenses, which will readily suggest themselves to the mind. Crimes like these just mentioned can only be committed by natural persons, and statutes in relation thereto are for this reason never construed as referring to corporations; but when a statute in general terms prohibits the doing of an act which can be performed by a corporation, and does not expressly exempt corporations from its provisions, there is no reason why such statute should be construed as not applying to them, when the punishment provided for its infraction is one than can be inflicted upon a corporation, — as, for instance, a fine. In the act of Congress now under consideration it is made an offense for any contractor or subcontractor whose duty it shall be to employ, direct, or control any laborer employed upon any of the public works of the United States, to require or permit such laborer to work more than eight hours in any calendar day. A corporation may be a contractor or

subcontractor in carrying on public works of the United States, and as such it has the power or capacity to violate this provision of the law. Corporations are, therefore, within the letter, and, as it is as much against the policy of the law for a corporation to violate these provisions as for a natural person so to do, they are also within the spirit of this statute; and no reason is perceived why a corporation which does the prohibited act should be exempt from the punishment prescribed therefor. If the law should receive the construction contended for by the defendant, the result would be that a corporation, in contracting for the doing of any public work, would be given a privilege denied to a natural person. Such an intention should not be imputed to Congress, unless its language will admit of no other interpretation.

NOTE. — See, *accord*, *Evans & Co., Ltd.*, v. *London County Council*, [1914] 3 K.B. 315.

The legislature may impose upon a railway corporation the duty of providing an adequate supply of pure drinking water for its passengers, and may provide that the corporation shall be indicted, prosecuted, and fined for a neglect of this duty (*Southern Railway Co.* v. *State*, 125 Ga. 287); a railroad corporation, constructing its railroad across a highway without lawful authority is liable to indictment for a nuisance (*Commonwealth* v. *Vermont R.R. Corporation*, 4 Gray [Mass.] 22); a corporation may be found guilty of having in its possession, with intent to sell, impure milk (*Commonwealth* v. *Graustein & Co.*, 209 Mass. 38); so, of selling goods which were underweight (*State* v. *Creamery Co.*, 83 Kan. 389); so, of mailing obscene matter (*United States* v. *New York Herald Co.*, 159 Fed. 296); so, of taking usury (*State* v. *First National Bank*, 2 S.D. 568); so, of cruelty to animals (*Baltimore R.R. Co.* v. *United States*, 220 U.S. 94); so, of keeping a disorderly house (*State* v. *Passaic County Society*, 54 N.J.L. 260); so, of a contempt of court (*Telegram Newspaper Co.* v. *Commonwealth*, 172 Mass. 294; *Rex* v. *J. G. Hammond & Co., Ltd.*, [1914] 2 K.B. 866).

STATE *v.* EASTERN COAL CO.

29 R.I. 254. 1908.

DUBOIS, J. These are indictments charging the defendants with conspiracy. The cases were heard together, and came to this court upon certifications from the Superior Court for the counties of Providence and Bristol, under C.P.A., § 478.

The material portions of the four counts in each of the indictments set out that the defendants "unlawfully and fraudulently did

combine, confederate and conspire together by divers unlawful and fraudulent devices, contrivances and acts, unlawfully to regulate and fix the price at which coal should be sold in the said City of Providence, to the prejudice of the public and of the consumers of said coal, which said coal was then and there an article of prime necessity to the public and the consumers thereof"; and that the defendants "wilfully devising and intending to regulate and fix the price of a prime necessity of life in said City of Providence, did unlawfully and maliciously conspire, combine, confederate and agree together to do an illegal act injurious to the public trade in reference to a prime necessity of life, to wit, to then and there, in restraint of trade and to the injury of the public trade, unlawfully create, enter into and become members of and parties to a trust, agreement, combination, confederation and understanding, with each other wrongfully and unlawfully to regulate and fix the price at which coal should be sold in the City of Providence, which said coal was then and there an article of prime necessity to the public and consumers thereof"; and also that the defendants "unlawfully, fraudulently, maliciously, wrongfully and wickedly did conspire and agree together to do an illegal act injurious to the public trade, to wit, to then and there unlawfully regulate and fix the price at which anthracite coal should be sold in the City of Providence, which said anthracite coal was then and there an article of prime necessity to the public and the consumers thereof, and that the defendants did unlawfully and fraudulently fix and regulate the price of anthracite coal in said City of Providence"; and finally, that the defendants "unlawfully, fraudulently, maliciously, wrongfully and wickedly did conspire and agree together to do an illegal act injurious to the public trade, to wit, to then and there unlawfully regulate and fix the price at which coal should be sold in said City of Providence, which said coal was then and there an article of prime necessity to the said public and consumers thereof."

The following are the questions certified for our determination. . . .

The eighth question raises the inquiry: Has a corporation the ability to commit this kind of crime?

The defendants, in support of their contention that it has not, argue as follows: "We submit that, on principle and authority, a corporation has not, from its very nature, the capacity to commit this offense. It is too plain to require argument that this intangible entity cannot actually do any act requiring any mental, moral, or spiritual process, or any act, as it is more frequently put, requiring intent. In civil cases the intent of the officer or agent is sometimes imputed to the corporation, it is true, but this doctrine is admittedly a pure legal fiction, based on grounds of public policy.

"In civil cases a party has been injured and is seeking compensation. Balancing the equities of the plaintiff and the stockholders

of the defendant corporation, it has seemed more just that the person injured should be reimbursed than that an individual stockholder should be absolved from liability forced upon him by an officer of the corporation. But in criminal cases the theory is adequate punishment for an offense against the State. The punishment may be out of all proportion to the benefit gained by the commission of the crime, and never has any logical relation to it. Oftentimes no advantage is gained by the corporation, so that to punish an innocent stockholder for an offense really committed by an officer of the corporation can have no basis in justice. Furthermore, all the benefit of the preventive objects of the punishment can be accomplished by punishing those who are in fact the wrongdoers."

The following argument in behalf of the affirmative of the question is presented by the attorney-general:

"Conspiracy is a misdemeanor at common law, and not a felony. There is nothing peculiar connected with the element of intent involved in the crime of conspiracy which differs from the element of intent in other ordinary misdemeanors. If the contention of the defendants is held to be good it would seem to necessarily follow that a corporation could not be held guilty of any of the ordinary crimes where the question of intent was involved. In the early history of corporations they were held to be without power of action except through their agents, and therefore they could not be guilty of a crime requiring a criminal intent. It is believed that this theory has long since been exploded both in England and America. At the present time there seems to be very little doubt that corporations may be guilty of most of the common crimes, and that criminal intent will be imputed to the corporation from acts done by its agents. It is still held in some jurisdictions that corporations can not be guilty of a felony, or crimes where personal violence is involved, but that is as far as any courts, it is believed, will now go in holding that they cannot be guilty of crime. The tendency of the present time is to hold corporations responsible, criminally as well as civilly, for all acts committed by their agents, having any relation to the business of the corporation.

"It has been repeatedly held that a corporation may be guilty of criminal libel, of maintaining the various kinds of nuisances, and of violations of the various obligations which it owes to the public. Some States even hold them capable of committing the crime of assault and battery and other similar crimes.

"It is now universally held that corporations may be liable for all kinds of torts, including conspiracy. It is further generally held that a corporation is liable in exemplary or punitive damages, damages which from their very nature are only allowed as punishment for an actual wrong committed, which the law presupposes

that the defendant had the volition or initiatory power to commit or not to commit. The intention of the officers and agents of the corporation is imputed to the corporation in these civil cases, but that is what is done in all other cases where a corporation is held criminally liable. Corporations are held amenable for acts of conspiracy in the enforcement of contracts in civil law. Why should there be a distinction in the law with regard to conspiracy between that which is criminal and that which is civil?"

In support of their argument, the defendants also quote 2 Morawetz on Corporations, 2d ed., § 732: "It is sometimes said that the act of an agent is, in law, the act of his principal; but it is well to bear in mind that this is a mere fiction. A principal is frequently liable for the acts of his agents, as if he had done the acts himself; the reason of the liability, however, is not always the same. Sometimes the principal is chargeable by reason of his previous consent, sometimes by reason of his subsequent adoption of the act of the agent, and sometimes by reason of a rule of positive law established upon the grounds of public policy, which is the ultimate source of all law. It is for the latter reason that a principal may often be held civilly responsible for the torts of his agents, though in no manner at fault himself; and this is true, even where the tort involves a malicious intention on the part of the wrong-doer.

"But public policy certainly does not demand that a person or association should be punished by the State, through criminal proceedings, on account of a wrong committed by another. This would be contrary to the natural sense of justice. Hence it is held that where the commission of a crime involves the intention of the offender, this intention cannot be imputed by means of a fiction; actual intention is required.

"It follows, therefore, that a corporation cannot be charged criminally with a crime involving malice, or the intention of the offender. Even though the corporators themselves should unanimously join, with malice aforethought, in committing a crime as a corporate act, yet the malice would be that of the several members of the company, and not actually one malicious intention of the whole company."

This doctrine, however, is contrary to that held in *The Buffalo Lubricating Oil Company* v. *The Standard Oil Company of New York*, 106 N.Y. 669 (1887): "We entertain no doubt that the action against a corporation may be maintained to recover damages caused by conspiracy. *Morton* v. *Metropolitan Life Ins. Co.*, 34 Hun. 366; affirmed, 103 N.Y. 645; *Reed* v. *Home Savings Bank*, 130 Mass. 443; *Krulevitz* v. *Eastern R.R. Co.*, 140 Mass. 575; *Western News Co.* v. *Wilmarth*, 33 Kan. 510. If actions can be maintained against corporations for malicious prosecution, libel, assault and battery and other torts, we can perceive no reason for holding that actions may not

be maintained against them for conspiracy. It is well settled by the authorities cited, that the malice and wicked intent needful to sustain such actions may be imputed to corporations."

If corporations have the capacity to engage in actionable conspiracy they have the power to criminally conspire. We are of the opinion that the better reasoning supports the contention that corporations can conspire, and therefore answer the eighth question in the affirmative.

NOTE. — In *Telegram Newspaper Co.* v. *Commonwealth*, 172 Mass. 294, the court said (p. 296): "It is said that an intent cannot be imputed to a corporation in criminal proceedings. It has been decided in this Commonwealth that a corporation may be liable civilly for a libel or a malicious prosecution. We think that a corporation may be liable criminally for certain offenses of which a specific intent may be necessary. There is no more difficulty in imputing to a corporation a specific intent in criminal proceedings than in civil."

In *State* v. *Passaic County Society*, 54 N.J.L. 260, the court said (p. 264): "The very basis of the action for libel or for malicious prosecution is the evil intent, the malice of the party defendant. It is difficult, therefore, to see how a corporation may be amenable to civil suit for libel and malicious prosecution and private nuisance, and mulcted in exemplary damages, and at the same time not be indictable for like offenses, where the injury falls upon the public."

PEOPLE *v.* ROCHESTER RAILWAY & LIGHT CO.

195 N.Y. 102. 1909.

HISCOCK, J. The respondent has been indicted for the crime of manslaughter in the second degree because, as alleged, it installed certain apparatus in a residence in Rochester in such a grossly improper, unskillful and negligent manner that gases escaped and caused the death of an inmate.

The demurrer to the indictment has presented the question whether a corporation may be thus indicted for manslaughter, under § 193 of the Penal Code.

Before proceeding to the interpretation of this specific provision we shall consider very briefly the general question discussed by the parties whether a corporation is capable of committing in any form such a crime as that of manslaughter.

Of the correctness of the proposition urged in behalf of the People that it may do so, subject to various limitations, we entertain no doubt.

Some of the earlier writers on the common law held that a corpo-

ration could not commit a crime. Blackstone in his Commentaries, Book 1, page 476, stated: "A corporation cannot commit treason or felony, or other crime, in its corporate capacity: though its members may, in their distinct individual capacities." And Lord Chief Justice HOLT (*Anonymous*, 12 Modern, 559) is said to have held that "a corporation is not indictable, but the particular members of it are." In modern times, however, the courts and text writers quite universally have reached an opposite conclusion. A corporation may be indicted either for nonfeasance or misfeasance, the obvious and general limitations upon this liability being in the former case that it shall be capable of doing the act of non-performance of which it is charged, and that in the second case the act for the performance of which it is charged shall not be one of which performance is clearly and totally beyond its authorized powers. Bishop's New Criminal Law, §§ 421, 422.

The instances in which it has been held that a corporation might be liable criminally simply because it did or did not perform some act, and where no element of intent was supposed to be involved, are so familiar that any extended reference to them is entirely unnecesary. The latest authority in this state upholding such liability is found in the case of *People* v. *Woodbury Dermatological Institute*, 192 N.Y. 455, where it was held that a corporation might be punished criminally for disobeying the statute providing that "any person not a registered physician who shall advertise to practice medicine, shall be guilty of a misdemeanor." There was involved no question of intent, but simply disobedience of a statutory prohibition against doing certain acts.

At times courts have halted somewhat at the suggestion that a corporation could commit a crime whereof the element of intent was an essential ingredient. But this doctrine, again with certain limitations, may now be regarded as established, and there is nothing therein which is either unjust or illogical.

Of course, it has been fully recognized that there are many crimes so involving personal, malicious intent and acts *ultra vires* that a corporation manifestly could not commit them. Wharton's Criminal Law (9th ed.), 191; Morawetz on Private Corporations (2d ed.), § 732 *et seq.* But a corporation, generally speaking, is liable in civil proceedings for the conduct of the agents through whom it conducts its business so long as they act within the scope of their authority, real or apparent, and it is but a step further in the same direction to hold that in many instances it may be charged criminally with the unlawful purposes and motives of such agents while so acting in its behalf. . . .

Within the principles thus and elsewhere declared, we have no doubt that a definition of certain forms of manslaughter might have been formulated which would be applicable to a corporation, and

make it criminally liable for various acts of misfeasance and nonfeasance when resulting in death, and amongst which very probably might be included conduct in its substance similar to that here charged against the respondent. But this being so, the question still confronts us whether corporations have been so made liable for the crime of manslaughter as now expressly defined in the section alone relied on by the People, and this question we think must be decisively answered in the negative.

§ 179 of the Penal Code defines homicide as "the killing of one human being by the act, procurement or omission of another." We think that this final word "another" naturally and clearly means a second or additional member of the same kind or class alone referred to by the preceding words, namely, another human being, and that we should not interpret it as appellant asks us to, as meaning another "person," which might then include corporations. It seems to us that it would be a violent strain upon a criminal statute to construe this word as meaning an agency of some kind other than that already mentioned or referred to, and as bridging over a radical transition from human beings to corporations. Therefore we construe this definition of homicide as meaning the killing of one human being by another human being.

§ 180 says that "Homicide is either: 1. Murder; 2. Manslaughter," etc. § 193 says that: "Such homicide," that is, "the killing of one human being . . . by another," is manslaughter in the second degree when committed "without a design to effect death. . . . 3. By any act, procurement or culpable negligence of any person, which . . . does not constitute the crime of murder in the first or second degree, nor manslaughter in the first degree." Thus we have the underlying and fundamental definition of homicide as the killing of one human being by another human being, and out of this basic act thus defined and according to the circumstances which accompany it are established crimes of varying degree including that of manslaughter for which the respondent has been indicted. In the definition of these crimes as contained in the sections under consideration (§§ 183–193) we do not discover any evidence of an intent on the part of the legislature to abandon the limitiation of its enactments to human beings or to include a corporation as a criminal. Many of these sections could not by any possibility apply to a corporation and in our opinion subdivision 3 of § 193 relating to manslaughter manifestly does not. It is true that the term "person" used therein may at times include corporations but that is not the case here. The surrounding and related sections are not calculated to induce the belief that it has any such meaning, and the classification of manslaughter as a form of homicide and the definition of homicide already quoted forbid it.

The judgment should be affirmed.

CULLEN, Ch.J., GRAY, EDWARD T. BARTLETT, WERNER, WILLARD BARTLETT and CHASE, JJ., concur.

Judgment affirmed.

NOTE. — A railroad corporation may be indicted and fined in case of a loss of life by reason of the negligence of the members, or their servants. *Boston R.R.* v. *State*, 32 N.H. 215.

For other cases, in addition to the principal case, where the court concluded that the legislature had not intended that corporations should come within the scope of a statute defining an offense, see *United States* v. *Braun*, 158 Fed. 456; *Pharmaceutical Society* v. *London Ass'n, Ltd.*, L.R. 5 App. Cas. 857; *Hauke* v. *Hulton & Co., Ltd.*, [1909] 2 K.B. 93 (offender to be deemed "a rogue and vagabond").

CHAPTER II.

OFFENSES UNDER THE SHERMAN ANTI-TRUST ACT.

26 U.S. STAT. 209. JULY 2, 1890.

An Act to protect trade and commerce against unlawful restraints and monopolies.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, —

Sec. 1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Sec. 2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Sec. 3. Every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce in any Territory of the United States or of the District of Columbia, or in restraint of trade or commerce between any such Territory and another, or between any such Territory or Territories and any State or States or the District of Columbia, or with foreign nations, or between the District of Columbia and any State or States or foreign nations, is hereby declared illegal. Every person who shall make any such contract or engage in any such combination or conspiracy, shall be deemed guilty of a misdemeanor, and, on conviction thereof, shall be punished by fine not exceeding five thousand dollars, or by imprisonment not exceeding one year, or by both said punishments, in the discretion of the court.

Sec. 4. The several circuit courts of the United States are hereby invested with jurisdiction to prevent and restrain violations of this

act; and it shall be the duty of the several district attorneys of the United States, in their respective districts, under the direction of the Attorney-General, to institute proceedings in equity to prevent and restrain such violations. Such proceedings may be by way of petition setting forth the case and praying that such violation shall be enjoined or otherwise prohibited. When the parties complained of shall have been duly notified of such petition the court shall proceed, as soon as may be, to the hearing and determination of the case; and pending such petition and before final decree, the court may at any time make such temporary restraining order or prohibition as shall be deemed just in the premises.

Sec. 5. Whenever it shall appear to the court before which any proceedings under section four of this act may be pending, that the ends of justice require that other parties should be brought before the court, the court may cause them to be summoned, whether they reside in the district in which the court is held or not; and subpœnas to that end may be served in any district by the marshal thereof.

Sec. 6. Any property owned under any contract or by any combination, or pursuant to any conspiracy (and being the subject thereof) mentioned in section one of this act, and being in the course of transportation from one State to another, or to a foreign country, shall be forfeited to the United States, and may be seized and condemned by like proceedings as those provided by law for the forfeiture, seizure, and condemnation of property imported into the United States contrary to law.

Sec. 7. Any person who shall be injured in his business or property by any other person or corporation by reason of anything forbidden or declared to be unlawful by this act, may sue therefor in any circuit court of the United States in the district in which the defendant resides or is found, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the costs of suit, including a reasonable attorney's fee.

Sec. 8. That the word "person," or "persons," wherever used in this act shall be deemed to include corporations and associations existing under or authorized by the laws of either the United States, the laws of any of the Territories, the laws of any State, or the laws of any foreign country.

Note. — See also the Clayton Anti-Trust Act, 38 U.S. Stat. 730 (Oct. 15, 1914).

UNITED STATES *v.* E. C. KNIGHT CO.

156 U.S. 1. 1894.

MR. CHIEF JUSTICE FULLER delivered the opinion of the court.

The material facts proved are that the American Sugar Refining Co., one of the defendants, is incorporated under the laws of New Jersey, and has authority to purchase, refine, and sell sugar; that the Franklin Sugar Refinery, the E. C. Knight Co., the Spreckels Sugar Refinery, and the Delaware Sugar House, were incorporated under the laws of Pennsylvania, and authorized to purchase, refine, and sell sugar; that the four latter Pennsylvania companies were located in Philadelphia, and prior to March, 1892, produced about thirty-three per cent of the total amount of sugar refined in the United States, and were in active competition with the American Sugar Refining Co., and with each other, selling their product wherever demand was found for it throughout the United States; that prior to March, 1892, the American Sugar Refining Co. had obtained control of all refineries in the United States, excepting the four located in Philadelphia, and that of the Revere Co. in Boston, the latter producing about two per cent of the amount refined in this country; that in March, 1892, the American Sugar Refining Co. entered into contracts (on different dates) with the stockholders of each of the Philadelphia corporations named, whereby it purchased their stock, paying therefor by transfers of stock in its company; that the American Sugar Refining Co. thus obtained possession of the Philadelphia refineries and their business; that each of the purchases was made subject to the American Sugar Refining Co. obtaining authority to increase its stock $25,000,000; that this assent was subsequently obtained and the increase made; that there was no understanding or concert action between the stockholders of the several Philadelphia companies respecting the sales, but that those of each company acted independently of those of the others, and in ignorance of what was being done by such others; that the stockholders of each company acted in concert with each other, understanding and intending that all the stock and property of the company should be sold; that the contract of sale in each instance left the sellers free to establish other refineries and continue the business if they should see fit to do so, and contained no provision respecting trade or commerce in sugar, and that no arrangement or provision on this subject has been made since; that since the purchase the Delaware Sugar House Refinery has been operated in conjunction with the Spreckels Refinery, and the E. C. Knight Refinery in connection with the Franklin, this combination being made apparently for reasons of economy in conducting the business; that the amount of sugar refined in Philadelphia has been increased

since the purchases; that the price has been slightly advanced since that event, but is still lower than it had been for some years before, and up to within a few months of the sales; that about ten per cent of the sugar refined and sold in the United States is refined in other refineries than those controlled by the American Sugar Refining Co.; that some additional sugar is produced in Louisiana and some is brought from Europe, but the amount is not large in either instance.

The object in purchasing the Philadelphia refineries was to obtain a greater influence or more perfect control over the business of refining and selling sugar in this country.

The Circuit Court held that the facts did not show a contract, combination, or conspiracy to restrain or monopolize trade or commerce "among the several States or with foreign nations," and dismissed the bill. 60 Fed. Rep. 306. The cause was taken to the Circuit Court of Appeals for the Third Circuit, and the decree affirmed. 60 Fed. Rep. 934. This appeal was then prosecuted.

The fundamental question is, whether conceding that the existence of a monopoly in manufacture is established by the evidence, that monopoly can be directly suppressed under the act of Congress in the mode attempted by this bill.

The argument is that the power to control the manufacture of refined sugar is a monopoly over a necessary of life, to the enjoyment of which by a large part of the population of the United States interstate commerce is indispensable, and that, therefore, the general government in the exercise of the power to regulate commerce may repress such monopoly directly and set aside the instruments which have created it. But this argument cannot be confined to necessaries of life merely, and must include all articles of general consumption. Doubtless the power to control the manufacture of a given thing involves in a certain sense the control of its disposition, but this is a secondary and not the primary sense; and although the exercise of that power may result in bringing the operation of commerce into play, it does not control it, and affects it only incidentally and indirectly. Commerce succeeds to manufacture, and is not a part of it. The power to regulate commerce is the power to prescribe the rule by which commerce shall be governed, and is a power independent of the power to suppress monopoly. But it may operate in repression of monopoly whenever that comes within the rules by which commerce is governed or whenever the transaction is itself a monopoly of commerce.

It will be perceived how far-reaching the proposition is that the power of dealing with a monopoly directly may be exercised by the general government whenever interstate or international commerce may be ultimately affected. The regulation of commerce applies to the subject of commerce and not to matters of internal police.

Contracts to buy, sell, or exchange goods to be transported among the several States, the transportation and its instrumentalities, and articles bought, sold, or exchanged for the purposes of such transit among the States, or put in the way of transit, may be regulated, but this is because they form part of interstate trade or commerce. The fact that an article is manufactured for export to another State does not of itself make it an article of interstate commerce, and the intent of the manufacturer does not determine the time when the article or product passes from the control of the State and belongs to commerce. This was so ruled in *Coe* v. *Errol*, 116 U.S. 517, 525, in which the question before the court was whether certain logs cut at a place in New Hampshire and hauled to a river town for the purpose of transportation to the State of Maine were liable to be taxed like other property in the State of New Hampshire. Mr. Justice BRADLEY, delivering the opinion of the court, said: "Does the owner's state of mind in relation to the goods, that is, his intent to export them, and his partial preparation to do so, exempt them from taxation? This is the precise question for solution. . . . There must be a point of time when they cease to be governed exclusively by the domestic law and begin to be governed and protected by the national law of commercial regulation, and that moment seems to us to be a legitimate one for this purpose, in which they commence their final movement from the State of their origin to that of their destination."

Contracts, combinations, or conspiracies to control domestic enterprise in manufacture, agriculture, mining, production in all its forms, or to raise or lower prices or wages, might unquestionably tend to restrain external as well as domestic trade, but the restraint would be an indirect result, however inevitable and whatever its extent, and such result would not necessarily determine the object of the contract, combination, or conspiracy.

Again, all the authorities agree that in order to vitiate a contract or combination it is not essential that its result should be a complete monopoly; it is sufficient if it really tends to that end and to deprive the public of the advantages which flow from free competition. Slight reflection will show that if the national power extends to all contracts and combinations in manufacture, agriculture, mining, and other productive industries, whose ultimate result may effect external commerce, comparatively little of business operations and affairs would be left for state control.

It was in the light of well-settled principles that the act of July 2, 1890, was framed. Congress did not attempt thereby to assert the power to deal with monopoly directly as such; or to limit and restrict the rights of corporations created by the States or the citizens of the States in the acquisition, control, or disposition of property; or to regulate or prescribe the price or prices at which such property or

the products thereof should be sold; or to make criminal the acts of persons in the acquisition and control of property which the States of their residence or creation sanctioned or permitted. Aside from the provisions applicable where Congress might exercise municipal power, what the law struck at was combinations, contracts, and conspiracies to monopolize trade and commerce among the several States or with foreign nations; but the contracts and acts of the defendants related exclusively to the acquisition of the Philadelphia refineries and the business of sugar refining in Pennsylvania, and bore no direct relation to commerce between the States or with foreign nations. The object was manifestly private gain in the manufacture of the commodity, but not through the control of interstate or foreign commerce. It is true that the bill alleged that the products of these refineries were sold and distributed among the several States, and that all the companies were engaged in trade or commerce with the several States and with foreign nations; but this was no more than to say that trade and commerce served manufacture to fulfill its function. Sugar was refined for sale, and sales were probably made at Philadelphia for consumption, and undoubtedly for resale by the first purchasers throughout Pennsylvania and other States, and refined sugar was also forwarded by the companies to other States for sale. Nevertheless it does not follow that an attempt to monopolize, or the actual monopoly of, the manufacture was an attempt, whether executory or consummated, to monopolize commerce, even though, in order to dispose of the product, the instrumentality of commerce was necessarily invoked. There was nothing in the proofs to indicate any intention to put a restraint upon trade or commerce, and the fact, as we have seen, that trade or commerce might be indirectly affected was not enough to entitle complainants to a decree. The subject-matter of the sale was shares of manufacturing stock, and the relief sought was the surrender of property which had already passed and the suppression of the alleged monopoly in manufacture by the restoration of the *status quo* before the transfers; yet the act of Congress only authorized the Circuit Courts to proceed by way of preventing and restraining violations of the act in respect to contracts, combinations, or conspiracies in restraint of interstate or international trade or commerce.

The Circuit Court declined, upon the pleadings and proofs, to grant the relief prayed, and dismissed the bill, and we are of opinion that the Circuit Court of Appeals did not err in affirming that decree.

Decree affirmed.

Mr. Justice Harlan dissented.

Note. — For other cases in which the court held that the acts of the defendants did not offend against the Anti-Trust Act because

the effect, if any, of their acts upon interstate commerce was indirect and incidental see *Hopkins* v. *United States*, 171 U.S. 578; *Anderson* v. *United States*, 171 U.S. 604; *Field* v. *Barber Asphalt Co.*, 194 U.S. 618; *Cincinnati Co.* v. *Bay*, 200 U.S. 179. See also *Board of Trade* v. *Christie Grain & Stock Co.*, 198 U.S. 236, 252.

American Banana Co. v. *United Fruit Co.*, 213 U.S. 347. The prohibitions of the Anti-Trust Act do not extend to acts done in foreign countries even though done by citizens of the United States and injuriously affecting other citizens of the United States.

UNITED STATES *v.* FREIGHT ASSOCIATION.

166 U.S. 290. 1897.

CERTAIN competing railroads entered into an agreement "for the purpose of mutual protection by establishing and maintaining reasonable rates, rules and regulations on all freight traffic, both through and local." A committee was created to adopt rates, which were to be the governing rates for all the railroads. Charging a rate not so adopted subjected the railroad making the charge to a penalty.

The Government asked that, under the provisions of the Anti-Trust Act, the defendants be enjoined from continuing to act pursuant to the terms of such agreement.

MR. JUSTICE PECKHAM. [The court held that the Anti-Trust Act applied to common carriers by railroad.]

Second. The next question to be discussed is as to what is the true construction of the statute, assuming that it applies to common carriers by railroad. What is the meaning of the language as used in the statute, that "every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several States or with foreign nations, is hereby declared to be illegal"? Is it confined to a contract or combination which is only in unreasonable restraint of trade or commerce, or does it include what the language of the act plainly and in terms covers, all contracts of that nature?

We are asked to regard the title of this act as indicative of its purpose to include only those contracts which were unlawful at common law, but which require the sanction of a Federal statute in order to be dealt with in a Federal court. It is said that when terms which are known to the common law are used in a Federal statute those terms are to be given the same meaning that they received at common law, and that when the language of the title is "to protect trade and commerce against unlawful restraints and monopolies," it means those restraints and monopolies which the common

law regarded as unlawful, and which were to be prohibited by the Federal statute. We are of opinion that the language used in the title refers to and includes and was intended to include those restraints and monopolies which are made unlawful in the body of the statute. It is to the statute itself that resort must be had to learn the meaning thereof, though a resort to the title here creates no doubt about the meaning of and does not alter the plain language contained in its text.

It is now with much amplification of argument urged that the statute, in declaring illegal every combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce, does not mean what the language used therein plainly imports, but that it only means to declare illegal any such contract which is in *unreasonable* restraint of trade, while leaving all others unaffected by the provisions of the act; that the common law meaning of the term "contract in restraint of trade" includes only such contracts as are in *unreasonable* restraint of trade, and when that term is used in the Federal statute it is not intended to include all contracts in restraint of trade, but only those which are in unreasonable restraint thereof.

The term is not of such limited signification. Contracts in restraint of trade have been known and spoken of for hundreds of years both in England and in this country, and the term includes all kinds of those contracts which in fact restrain or may restrain trade. Some of such contracts have been held void and unenforceable in the courts by reason of their restraint being unreasonable, while others have been held valid because they were not of that nature. A contract may be in restraint of trade and still be valid at common law. Although valid, it is nevertheless a contract in restraint of trade, and would be so described either at common law or elsewhere. By the simple use of the term "contract in restraint of trade," all contracts of that nature, whether valid or otherwise, would be included, and not alone that kind of contract which was invalid and unenforceable as being in unreasonable restraint of trade. When, therefore, the body of an act pronounces as illegal every contract or combination in restraint of trade or commerce among the several States, etc., the plain and ordinary meaning of such language is not limited to that kind of contract alone which is in unreasonable restraint of trade, but all contracts are included in such language, and no exception or limitation can be added without placing in the act that which has been omitted by Congress.

Proceeding, however, upon the theory that the statute did not mean what its plain language imported, and that it intended in its prohibition to denounce as illegal only those contracts which were in unreasonable restraint of trade, the courts below have made an exhaustive investigation as to the general rules which guide courts in declaring contracts to be void as being in restraint of trade, and

therefore against the public policy of the country. In the course of their discussion of that subject they have shown that there has been a gradual though great alteration in the extent of the liberty granted to the vendor of property in agreeing, as part consideration for his sale, not to enter into the same kind of business for a certain time or within a certain territory. So long as the sale was the *bona fide* consideration for the promise and was not made a mere excuse for an invasion of the rule itself, the later authorities, both in England and in this country, exhibit a strong tendency towards enabling the parties to make such a contract in relation to the sale of property, including an agreement not to enter into the same kind of business, as they may think proper, and this with the view to granting to a vendor the freest opportunity to obtain the largest consideration for the sale of that which is his own. A contract which is the mere accompaniment of the sale of property, and thus entered into for the purpose of enhancing the price at which the vendor sells it, which in effect is collateral to such sale, and where the main purpose of the whole contract is accomplished by such sale, might not be included within the letter or spirit of the statute in question. But we cannot see how the statute can be limited, as it has been by the courts below, without reading into its text an exception which alters the natural meaning of the language used, and that, too, upon a most material point, and where no sufficient reason is shown for believing that such alteration would make the statute more in accord with the intent of the law-making body that enacted it.

The great stress of the argument for the defendants on this branch of the case has been to show, if possible, some reason in the attendant circumstances, or some fact existing in the nature of railroad property and business upon which to found the claim, that although by the language of the statute agreements or combinations in restraint of trade or commerce are included, the statute really means to declare illegal only those contracts, etc., which are in unreasonable restraint of trade. In order to do this the defendants call attention to many facts which they have already referred to in their argument, upon the point that railroads were not included at all in the statute. They again draw attention to the fact of the peculiar nature of railroad property. When a railroad is once built, it is said, it must be kept in operation; it must transport property, when necessary in order to keep its business, at the smallest price and for the narrowest profit, or even for no profit, provided running expenses can be paid, rather than not to do the work; that railroad property cannot be altered for use for any other purpose, at least without such loss as may fairly be called destructive; that competition while, perhaps, right and proper in other business, simply leads in railroad business to financial ruin and insolvency, and to the operation of the road by receivers in the interest of its creditors

instead of in that of its owners and the public; that a contest between a receiver of an insolvent corporation and one which is still solvent tends to ruin the latter company, while being of no benefit to the former; that a receiver is only bound to pay operating expenses, so he can compete with the solvent company and oblige it to come down to prices incompatible with any profit for the work done, and until ruin overtakes it to the destruction of innocent stockholders and the impairment of the public interests.

To the question why competition should necessarily be conducted to such an extent as to result in this relentless and continued war, to eventuate only in the financial ruin of one or all of the companies indulging in it, the answer is made that if competing railroad companies be left subject to the sway of free and unrestricted competition the results above foreshadowed necessarily happen from the nature of the case; that competition being the rule, each company will seek business to the extent of its power, and will underbid its rival in order to get the business, and such underbidding will act and react upon each company until the prices are so reduced as to make it impossible to prosper or live under them; that it is too much to ask of human nature for one company to insist upon charges sufficiently high to afford a reasonable compensation, and while doing so to see its patrons leave for rival roads who are obtaining its business by offering less rates for doing it than can be afforded and a fair profit obtained therefrom. Sooner than experience ruin from mere inanition, efforts will be made in the direction of meeting the underbidding of its rival until both shall end in ruin. The only refuge, it is said, from this wretched end lies in the power of competing roads agreeing among themselves to keep up prices for transportation to such sums as shall be reasonable in themselves, so that companies may be allowed to save themselves from themselves, and to agree not to attack each other, but to keep up reasonable and living rates for services performed. It is said that as railroads have a right to charge reasonable rates it must follow that a contract among themselves to keep up their charges to that extent is valid. Viewed in the light of all these facts it is broadly and confidently asserted that it is impossible to believe that Congress or any other intelligent and honest legislative body could ever have intended to include all contracts or combinations in restraint of trade, and as a consequence thereof to prohibit competing railways from agreeing among themselves to keep up prices for transportation to such a rate as should be fair and reasonable.

These arguments it must be confessed bear with much force upon the policy of an act which should prevent a general agreement upon the question of rates among competing railroad companies to the extent simply of maintaining those rates which were reasonable and fair.

There is another side to this question, however, and it may not be amiss to refer to one or two facts which tend to somewhat modify and alter the light in which the subject should be regarded. If only that kind of contract which is in unreasonable restraint of trade be within the meaning of the statute, and declared therein to be illegal, it is at once apparent that the subject of what is a reasonable rate is attended with great uncertainty. What is a proper standard by which to judge the fact of reasonable rates? Must the rate be so high as to enable the return for the whole business done to amount to a sum sufficient to afford the shareholder a fair and reasonable profit upon his investment? If so, what is a fair and reasonable profit? That depends sometimes upon the risk incurred, and the rate itself differs in different localities: which is the one to which reference is to be made as the standard? Or is the reasonableness of the profit to be limited to a fair return upon the capital that would have been sufficient to build and equip the road, if honestly expended? Or is still another standard to be created, and the reasonableness of the charges tried by the cost of the carriage of the article and a reasonable profit allowed on that? And in such case would contribution to a sinking fund to make repairs upon the roadbed and renewal of cars, etc., be assumed as a proper item? Or is the reasonableness of the charge to be tested by reference to the charges for transportation of the same kind of property made by other roads similarly situated? If the latter, a combination among such roads as to rates would, of course, furnish no means of answering the question. It is quite apparent, therefore, that it is exceedingly difficult to formulate even the terms of the rule itself which should govern in the matter of determining what would be reasonable rates for transportation. While even after the standard should be determined there is such an infinite variety of facts entering into the question of what is a reasonable rate, no matter what standard is adopted, that any individual shipper would in most cases be apt to abandon the effort to show the unreasonable character of a charge, sooner than hazard the great expense in time and money necessary to prove the fact, and at the same time incur the ill-will of the road itself in all his future dealings with it. To say, therefore, that the act excludes agreements which are not in unreasonable restraint of trade, and which tend simply to keep up reasonable rates for transportation, is substantially to leave the question of reasonableness to the companies themselves.

It must also be remembered that railways are public corporations organized for public purposes, granted valuable franchises and privileges, among which the right to take the private property of the citizen *in invitum* is not the least, *Cherokee Nation* v. *Southern Kansas Railway Co.*, 135 U.S. 641, 657; that many of them are the donees of large tracts of public lands and of gifts of money by mu-

nicipal corporations, and that they all primarily owe duties to the public of a higher nature even than that of earning large dividends for their shareholders. The business which the railroads do is of a public nature, closely affecting almost all classes in the community — the farmer, the artisan, the manufacturer and the trader. It is of such a public nature that it may well be doubted, to say the least, whether any contract which imposes any restraint upon its business would not be prejudicial to the public interest.

We recognize the argument upon the part of the defendants that restraint upon the business of railroads will not be prejudicial to the public interests so long as such restraint provides for reasonable rates for transportation and prevents the deadly competition so liable to result in the ruin of the roads and to thereby impair their usefulness to the public, and in that way to prejudice the public interest. But it must be remembered that these results are by no means admitted with unanimity; on the contrary, they are earnestly and warmly denied on the part of the public and by those who assume to defend its interests both in and out of Congress. Competition, they urge, is a necessity for the purpose of securing in the end just and proper rates.

It was said in *Gibbs* v. *Baltimore Gas Company*, 130 U.S. 396, at page 408, by Mr. Chief Justice FULLER, as follows: "The supplying of illuminating gas is a business of a public nature to meet a public necessity. It is not a business like that of an ordinary corporation engaged in the manufacture of articles that may be furnished by individual effort. *New Orleans Gas Co.* v. *Louisiana Light Co.*, 115 U.S. 650; *Louisville Gas Co.* v. *Citizens' Gas Co.*, 115 U.S. 683; *Shepard* v. *Milwaukee Gas Co.*, 6 Wisconsin, 539; *Chicago Gas Light & Coke Co.* v. *People's Gas Light & Coke Co.*, 121 Illinois, 530; *St. Louis* v. *St. Louis Gas Light Co.*, 70 Missouri, 69. Hence, while it is justly urged that those rules which say that a given contract is against public policy, should not be arbitrarily extended so as to interfere with the freedom of contract, *Printing, etc., Registering Co.* v. *Sampson*, L.R. 19 Eq. 462, yet in the instance of business of such a character that it presumably cannot be restrained to any extent whatever without prejudice to the public interest, courts decline to enforce or sustain contracts imposing such restraint, however partial, because in contravention of public policy. This subject is much considered, and the authorities cited in *West Virginia Transportation Co.* v. *Ohio River Pipe Line Co.*, 22 West Va. 600; *Chicago, etc., Gas Co.* v. *People's Gas Co.*, 121 Illinois, 530; *Western Union Telegraph Co.* v. *American Union Telegraph Co.*, 65 Georgia, 160."

It is true that in the *Gibbs case* there was a special statute which prohibited the company from entering into any consolidation, combination or contract with any other gas company whatever, and it was provided that any attempt to do so or to make such combina-

tion or contract should be utterly null and void. The above extract from the opinion of the court is made for the purpose of showing the difference which exists between a private and a public corporation — that kind of a public corporation which, while doing business for remuneration, is yet so connected in interest with the public as to give a public character to its business — and it is seen that while, in the absence of a statute prohibiting them, contracts of private individuals or corporations touching upon restraints in trade must be unreasonable in their nature to be held void, different considerations obtain in the case of public corporations like those of railroads where it well may be that any restraint upon a business of that character as affecting its rates of transportation must thereby be prejudicial to the public interests.

The plaintiffs are, however, under no obligation in order to maintain this action to show that by the common law all agreements among competing railroad companies to keep up rates to such as are reasonable were void as in restraint of trade or commerce. There are many cases which look in that direction if they do not precisely decide that point. Some of them are referred to in the opinion in the *Baltimore Gas Company case*, above cited. The case of the *Mogul Steamship Company* v. *McGregor*, 21 Q.B.D. 544; 23 Q.B.D. 598; 1892, App. Cas. 25, has been cited by the courts below as holding in principle that contracts of this nature are valid at common law. The agreement held valid there was an agreement for lowering rates of transportation among the parties thereto, and it was entered into for the purpose of driving out of trade rival steamships in order that thereafter the rates might be advanced. The English courts held that the agreement was not a conspiracy, and that it was valid, although the result aimed at was to drive a rival out of the field, because so long as the injury to such rival was not the sole reason for the agreement, but self-interest the predominating motive, there was nothing wrong in law with an agreement of that kind. But assuming that agreements of this nature are not void at common law and that the various cases cited by the learned courts below show it, the answer to the statement of their validity now is to be found in the terms of the statute under consideration. The provisions of the Interstate Commerce Act relating to reasonable rates, discriminations, etc., do not authorize such an agreement as this, nor do they authorize any other agreements which would be inconsistent with the provisions of this act.

The general reasons for holding agreements of this nature to be invalid even at common law, on the part of railroad companies are quite strong, if not entirely conclusive.

Considering the public character of such corporations, the privileges and franchises which they have received from the public in order that they might transact business, and bearing in mind how

closely and immediately the question of rates for transportation affects the whole public, it may be urged that Congress had in mind all the difficulties which we have before suggested of proving the unreasonableness of the rate, and might, in consideration of all the circumstances, have deliberately decided to prohibit all agreements and combinations in restraint of trade or commerce, regardless of the question whether such agreements were reasonable or the reverse.

It is true that, as to a majority of those living along its line, each railroad is a monopoly. Upon the subject now under consideration it is well said by Judge OLIVER P. SHIRAS, United States District Judge, Northern District of Iowa, in his very able dissenting opinion in this case in the United States Circuit Court of Appeals, as follows: —

"As to the majority of the community living along its line, each railway company has a monopoly of the business demanding transportation as one of its elements. By reason of this fact the action of this corporation in establishing the rates to be charged largely influences the net profit coming to the farmer, the manufacturer and the merchant, from the sale of the products of the farm, the workshop and manufactory, and of the merchandise purchased and resold, and also largely influences the price to be paid by every one who consumes any of the property transported over the line of railway. There is no other line of business carried on in our midst which is so intimately connected with the public as that conducted by the railways of the country. . . . A railway corporation engaged in the transportation of the persons and property of the community is always carrying on a public business which at all times directly affects the public welfare. All contracts or combinations entered into between railway corporations intended to regulate the rates to be charged the public for the service rendered, must of necessity affect the public interest. By reason of this marked distinction existing between enterprises inherently public in their character and those of a private nature, and further by reason of the difference between private persons and corporations engaged in private pursuits, who owe no direct or primary duty to the public, and public corporations created for the express purpose of carrying on public enterprises, and which, in consideration of the public powers exercised in their behalf, are under obligation to carry on the work entrusted to their management primarily in the interest and for the benefit of the community, it seems clear to me that the same test is not applicable to both classes of business and corporations in determining the validity of contracts and combinations entered into by those engaged therein. . . . In the opinion of the court are found citations from the reports of the Interstate Commerce Commission in which are depicted the evils that are occasioned to the railway companies and the public by warfares over rate charges, and the advantages that are gained in many directions by proper conference

and concert of action among the competing lines. It may be entirely true that as we proceed in the development of the policy of public control over railway traffic, methods will be devised and put in operation by legislative enactment whereby railway companies and the public may be protected against the evils arising from unrestricted competition and from rate wars which unsettle the business of the community, but I fail to perceive the force of the argument that because railway companies *through their own action cause evils to themselves* and the public by sudden changes or reductions in tariff rates they must be permitted to deprive the community of the benefit of competition in securing reasonable rates for the transportation of the products of the country. Competition, free and unrestricted, is the general rule which governs all the ordinary business pursuits and transactions of life. Evils, as well as benefits, result therefrom. In the fierce heat of competition the stronger competitor may crush out the weaker; fluctuations in prices may be caused that result in wreck and disaster; yet, balancing the benefits as against the evils, the law of competition remains as a controlling element in the business world. That free and unrestricted competition in the matter of railroad charges may be productive of evils does not militate against the fact that such is the law now governing the subject. No law can be enacted nor system be devised for the control of human affairs that in its enforcement does not produce some evil results, no matter how beneficial its general purpose may be. There are benefits and there are evils which result from the operation of the law of free competition between railway companies. The time may come when the companies will be relieved from the operation of this law, but they cannot, by combination and agreements among themselves, bring about this change. The fact that the provisions of the Interstate Commerce Act may have changed in many respects the conduct of the companies in the carrying on of the public business they are engaged in does not show that it was the intent of Congress, in the enactment of that statute, to clothe railway companies with the right to combine together for the purpose of avoiding the effects of competition on the subject of rates."

The whole opinion is a remarkably strong presentation of the views of the learned judge who wrote it.

Still, again, it is answered that the effects of free competition among railroad companies, as described by the counsel for the companies themselves in the course of their argument, are greatly exaggerated. According to that argument, the moment an agreement of this nature is prohibited the railroads commence to cut their rates, and they cease only with their utter financial ruin, leaving, perhaps, one to raise rates indefinitely when its rivals have been driven away. It is said that this is a most overdrawn statement, and that while

absolutely free competition may have in some instances and for a time resulted in injury to some of the railroads, it is not at all clear that the general result has been other than beneficial to the whole public, and not in the long run detrimental to the prosperity of the roads. It is matter of common knowledge that agreements as to rates have been continually made of late years, and that complaints of each company in regard to the violation of such agreements by its rivals have been frequent and persistent. Rate wars go on notwithstanding any agreement to the contrary, and the struggle for business among competing roads keeps on, and in the nature of things will keep on, any alleged agreement to the contrary notwithstanding, and it is only by the exercise of good sense and by the presence of a common interest that railroads, without entering into any affirmative agreement in regard thereto, will keep within the limit of exacting a fair and reasonable return for services rendered. These agreements have never been found really effectual for any extended period.

The Interstate Commerce Commission, from whose reports quotations have been quite freely made by counsel for the purpose of proving the views of its learned members in regard to this subject, has never distinctly stated that agreements among competing railroads to maintain prices are to be commended, or that the general effect is to be regarded as beneficial. They have stated in their fourth annual report that competition may degenerate into rate wars, and that such wars are as unsettling to the business of the country as they are mischievous to the carriers, and that the spirit of existing law is against them. They then add: "Agreements between railroad companies which from time to time they have entered into with a view to prevent such occurrences have never been found effectual, and for the very sufficient reason, that the mental reservations in forming them have been quite as numerous and more influential than the written stipulations." It would seem true, therefore, that there is no guaranty of financial health to be found in entering into agreements for the maintenance of rates, nor is financial ruin or insolvency the necessary result of their absence.

The claim that the company has the right to charge reasonable rates, and that, therefore, it has the right to enter into a combination with competing roads to maintain such rates, cannot be admitted. The conclusion does not follow from an admission of the premise. What one company may do in the way of charging reasonable rates is radically different from entering into an agreement with other and competing roads to keep up the rates to that point. If there be any competition the extent of the charge for the service will be seriously affected by that fact. Competition will itself bring charges down to what may be reasonable, while in the case of an agreement to keep prices up, competition is allowed no play; it is

shut out, and the rate is practically fixed by the companies themselves by virtue of the agreement, so long as they abide by it.

As a result of this review of the situation, we find two very widely divergent views of the effects which might be expected to result from declaring illegal all contracts in restraint of trade, etc.; one side predicting financial disaster and ruin to competing railroads, including thereby the ruin of shareholders, the destruction of immensely valuable properties, and the consequent prejudice to the public interest; while on the other side predictions equally earnest are made that no such mournful results will follow, and it is urged that there is a necessity, in order that the public interest may be fairly and justly protected, to allow free and open competition among railroads upon the subject of the rates for the transportation of persons and property.

The arguments which have been addressed to us against the inclusion of all contracts in restraint of trade, as provided for by the language of the act, have been based upon the alleged presumption that Congress, notwithstanding the language of the act, could not have intended to embrace all contracts, but only such contracts as were in unreasonable restraint of trade. Under these circumstances we are, therefore, asked to hold that the act of Congress excepts contracts which are not in unreasonable restraint of trade, and which only keep rates up to a reasonable price, notwithstanding the language of the act makes no such exception. In other words, we are asked to read into the act by way of judicial legislation an exception that is not placed there by the lawmaking branch of the Government, and this is to be done upon the theory that the impolicy of such legislation is so clear that it cannot be supposed Congress intended the natural import of the language it used. This we cannot and ought not to do. That impolicy is not so clear, nor are the reasons for the exception so potent as to permit us to interpolate an exception into the language of the act, and to thus materially alter its meaning and effect. It may be that the policy evidenced by the passage of the act itself will, if carried out, result in disaster to the roads and in a failure to secure the advantages sought from such legislation. Whether that will be the result or not we do not know and cannot predict. These considerations are, however, not for us. If the act ought to read as contended for by defendants, Congress is the body to amend it and not this court, by a process of judicial legislation wholly unjustifiable. Large numbers do not agree that the view taken by defendants is sound or true in substance, and Congress may and very probably did share in that belief in passing the act. The public policy of the Government is to be found in its statutes, and when they have not directly spoken, then in the decisions of the courts and the constant practice of the government officials; but when the lawmaking power speaks upon a particular

subject, over which it has constitutional power to legislate, public policy in such a case is what the statute enacts. If the law prohibits any contract or combination in restraint of trade or commerce, a contract or combination made in violation of such law is void, whatever may have been theretofore decided by the courts to have been the public policy of the country on that subject.

Mr. Chief Justice FULLER, Mr. Justice HARLAN, Mr. Justice BREWER, and Mr. Justice BROWN concurred.

Mr. Justice FIELD, Mr. Justice GRAY, Mr. Justice SHIRAS, and Mr. Justice WHITE dissented. Mr. Justice WHITE wrote the dissenting opinion, in the course of which he said: —

The theory upon which the contract is held to be illegal is that even though it be reasonable, and hence valid, under the general principles of law, it is yet void, because it conflicts with the act of Congress already referred to. Now, at the outset, it is necessary to understand the full import of this conclusion. As it is conceded that the contract does not unreasonably restrain trade, and that if it does not so unreasonably restrain, it is valid under the general law, the decision, substantially, is that the act of Congress is a departure from the general principles of law, and by its terms destroys the right of individuals or corporations to enter into very many reasonable contracts. But this proposition, I submit, is tantamount to an assertion that the act of Congress is itself unreasonable. The difficulty of meeting, by reasoning, a premise of this nature is frankly conceded, for, of course, where the fundamental proposition upon which the whole contention rests is that the act of Congress is unreasonable, it would seem conducive to no useful purpose to invoke reason as applicable to and as controlling the construction of a statute which is admitted to be beyond the pale of reason. The question, then, is, is the act of Congress relied on to be so interpreted as to give it a reasonable meaning, or is it to be construed as being unreasonable and as violative of the elementary principles of justice?

NOTE. — The doctrine of this case was reaffirmed in *United States* v. *Joint Traffic Association*, 171 U.S. 505. Mr. Justice PECKHAM again wrote the opinion, and the division of the court was the same as in the principal case, except that Mr. Justice FIELD was no longer a member of the court and his successor, Mr. Justice MCKENNA, took no part in the decision.

In *Shawnee Compress Co.* v. *Anderson*, 209 U.S. 423, Mr. Justice MCKENNA said (p. 434): "It has been decided that not only unreasonable but all direct restraints of trade are prohibited, the law being thereby distinguished from the common law."

See also, *Addyston Pipe Co.* v. *United States*, 175 U.S. 211; *Montague* v. *Lowry*, 193 U.S. 38; *Chattanooga Foundry* v. *Atlanta*, 203 U.S. 390; *Standard Sanitary Mfg. Co.* v. *United States*, 226 U.S. 20.

NORTHERN SECURITIES CO. *v.* UNITED STATES.

193 U.S. 197. 1904.

THE Great Northern Railway Company, a Minnesota corporation, owned and operated a line of railway extending from Superior, Duluth and St. Paul to Everett, Seattle and Portland, with a branch line to Helena. The Northern Pacific Railway Company, a Wisconsin corporation, owned and operated a line of railway extending from Ashland, Duluth and St. Paul to Helena, Spokane, Seattle, Tacoma and Portland. The two were engaged in active competition for freight and passenger traffic.

In 1901, James J. Hill, and associate stockholders in the Great Northern Railway Company, and J. Pierpont Morgan, and associate stockholders in the Northern Pacific Railway Company, entered into a combination to form, under the laws of New Jersey, a *holding* corporation, to be called the Northern Securities Company, to which, in exchange for its own capital stock upon a certain basis, was to be turned over the capital stock, or a controlling interest in the capital stock, of the two railroad corporations, with power in the holding corporation to vote such stock and to act in all respects as the owner thereof.

It was alleged and found that their purpose was to make the stockholders of each system jointly interested in both systems, and practically to pool the earnings of both for the benefit of the former stockholders of each, and to vest the selection of the directors and officers of each system in a common body, to wit, the holding corporation, with not only the power but the duty to pursue a policy which would promote the interests, not of one system at the expense of the other, but of both at the expense of the public. All inducement for competition between the two systems was to be removed, a virtual consolidation effected, and a monopoly of the interstate and foreign commerce formerly carried on by the two systems as independent competitors established.

The Northern Securities Company was organized. By its certificate of incorporation, one of its objects was stated to be "to acquire by purchase, subscription or otherwise, and to hold as investment, any bonds or other securities or evidences of indebtedness, or any shares of capital stock created or issued by any other corporation or corporations, association or associations, of the State of New Jersey, or of any other State, Territory or country." Through the issue of its stock it acquired more than nine-tenths of the stock of the Northern Pacific, and more than three-fourths of the stock of the Great Northern.

HARLAN, J. The stockholders of these two competing companies disappeared, as such, for the moment, but immediately reappeared

as stockholders of the holding company which was thereafter to guard the interests of both sets of stockholders as a unit, and to manage, or cause to be managed, both lines of railroad as if held *in one ownership*. Necessarily by this combination or arrangement the holding company in the fullest sense dominates the situation in the interest of those who were stockholders of the constituent companies; as much so, for every practical purpose, as if it had been itself a railroad corporation which had built, owned, and operated both lines for the exclusive benefit of its stockholders. Necessarily, also, the constituent companies ceased, under such a combination, to be in active competition for trade and commerce along their respective lines, and have become, practically, one powerful consolidated corporation, by the name of a holding corporation the principal, if not the sole, object for the formation of which was to carry out the purpose of the original combination under which competition between the constituent companies would cease. Those who were stockholders of the Great Northern and Northern Pacific and became stockholders in the holding company are now interested in preventing all competition between the two lines, and as owners of stock or of certificates of stock in the holding company, they will see to it that no competition is tolerated. They will take care that no persons are chosen directors of the holding company who will permit competition between the constituent companies. The result of the combination is that all the earnings of the constituent companies make a common fund in the hands of the Northern Securities Company, to be distributed, not upon the basis of the earnings of the respective constituent companies, each acting exclusively in its own interest, but upon the basis of the certificates of stock issued by the holding company. No scheme or device could more certainly come within the words of the act — "combination in the form of a trust or otherwise . . . in restraint of commerce among the several States or with foreign nations," — or could more effectively and certainly suppress free competition between the constituent companies. This combination is, within the meaning of the act, a "trust"; but if not, it is a *combination in restraint of interstate and international commerce;* and that is enough to bring it under the condemnation of the act. The mere existence of such a combination and the power acquired by the holding company as its trustee, constitute a menace to, and a restraint upon, that freedom of commerce which Congress intended to recognize and protect, and which the public is entitled to have protected. If such combination be not destroyed, all the advantages that would naturally come to the public under the operation of the general laws of competition, as between the Great Northern and Northern Pacific Railway companies, will be lost, and the entire commerce of the immense territory in the northern part of the United States between the Great Lakes

and the Pacific at Puget Sound will be at the mercy of a single holding corporation, organized in a State distant from the people of that territory.

Is the act to be construed as forbidding every combination or conspiracy in restraint of trade or commerce among the States or with foreign nations? Or, does it embrace only such restraints as are unreasonable in their nature? Is the motive with which a forbidden combination or conspiracy was formed at all material when it appears that the necessary tendency of the particular combination or conspiracy in question is to restrict or suppress free competition between competing railroads engaged in commerce among the States? . . .

[The court, after reviewing the decisions, stated, that, among the propositions established thereby, were the following:]

That the act is not limited to restraints of interstate and international trade or commerce that are unreasonable in their nature, but embraces *all* direct *restraints* imposed by any combination, conspiracy or monopoly upon such trade or commerce;

That Congress has the power to establish *rules* by which *interstate and international* commerce shall be governed, and, by the Anti-Trust Act, has prescribed the rule of free competition among those engaged in such commerce;

That *every* combination or conspiracy which would extinguish competition between otherwise competing railroads engaged in *interstate trade or commerce*, and which would *in that way* restrain *such* trade or commerce, is made illegal by the act;

That the natural effect of competition is to increase commerce, and an agreement whose direct effect is to prevent this play of competition restrains instead of promotes trade and commerce;

That to vitiate a combination, such as the act of Congress condemns, it need not be shown that the combination, in fact, results or will result in a total suppression of trade or in a complete monopoly, but is only essential to show that by its necessary operation it tends to restrain interstate or international trade or commerce or tends to create a monopoly in such trade or commerce and to deprive the public of the advantages that flow from free competition.

Many suggestions were made in argument based upon the thought that the Anti-Trust Act would in the end prove to be mischievous in its consequences. Disaster to business and wide-spread financial ruin, it has been intimated, will follow the execution of its provisions. Such predictions were made in all the cases heretofore arising under that act. But they have not been verified. It is the history of monopolies in this country and in England that predictions of ruin are habitually made by them when it is attempted, by legislation, to restrain their operations and to protect the public against their exactions.

But even if the court shared the gloomy forebodings in which the defendants indulge, it could not refuse to respect the action of the legislative branch of the Government if what it has done is within the limits of its constitutional power. The suggestions of disaster to business have, we apprehend, their origin in the zeal of parties who are opposed to the policy underlying the act of Congress or are interested in the result of this particular case; at any rate, the suggestions imply that the court may and ought to refuse the enforcement of the provisions of the act if, in its judgment, Congress was not wise in prescribing as a rule by which the conduct of interstate and international commerce is to be governed, that every combination, whatever its form, in restraint of such commerce and the monopolizing or attempting to monopolize such commerce shall be illegal. These, plainly, are questions as to the policy of legislation which belong to another department, and this court has no function to supervise such legislation from the standpoint of wisdom or policy. We need only say that Congress has authority to declare, and by the language of its act, as interpreted in prior cases, has in effect declared, that the freedom of interstate and international commerce shall not be obstructed or disturbed by any combination, conspiracy or monopoly that will restrain such commerce, by preventing the free operation of competition among interstate carriers engaged in the transportation of passengers and freight. This court cannot disregard that declaration unless Congress, in passing the statute in question, be held to have transgressed the limits prescribed for its action by the Constitution.

It was said in argument that the circumstances under which the Northern Securities Company obtained the stock of the constituent companies imported simply an investment in the stock of other corporations, a purchase of that stock; which investment or purchase, it is contended, was not forbidden by the charter of the company and could not be made illegal by any act of Congress. This view is wholly fallacious, and does not comport with the actual transaction. There was no actual investment, in any substantial sense, by the Northern Securities Company in the stock of the two constituent companies. If it was, in form, such a transaction, it was not, in fact, one of that kind. However that company may have acquired for itself any stock in the Great Northern and Northern Pacific Railway companies, no matter how it obtained the means to do so, all the stock it held or acquired in the constituent companies was acquired and held to be used in suppressing competition between those companies. It came into existence only for that purpose. If any one had full knowledge of what was designed to be accomplished, and as to what was actually accomplished, by the combination in question, it was the defendant Morgan. In his testimony he was asked, "Why put the stocks of *both* these [constituent

companies] into one holding company?" He frankly answered: "In the first place, this holding company was simply a question of *custodian*, because it had no other alliances." That disclosed the actual nature of the transaction, which was only to organize the Northern Securities Company as a *holding* company, in whose hands, not as a real purchaser or absolute owner, but simply as custodian, were to be placed the stocks of the constituent companies — such custodian to represent the combination formed between the shareholders of the constituent companies, the direct and necessary effect of such combination being, as already indicated, to restrain and monopolize interstate commerce by suppressing or (to use the words of this court in *United States* v. *Joint Traffic Association*) "smothering" competition between the lines of two railway carriers.

Mr. Justice BROWN, Mr. Justice MCKENNA, and Mr. Justice DAY concurred.

Mr. Justice BREWER, concurring in the result.

I cannot assent to all that is said in the opinion just announced, and believe that the importance of the case and the questions involved justify a brief statement of my views.

First, let me say that while I was with the majority of the court in the decision in *United States* v. *Freight Association*, 166 U.S. 290, followed by the cases of *United States* v. *Joint Traffic Association*, 171 U.S. 505, *Addyston Pipe & Steel Company* v. *United States*, 175 U.S. 211, and *Montague & Co.* v. *Lowry*, 193 U.S. 38, decided at the present term, and while a further examination (which has been induced by the able and exhaustive arguments of counsel in the present case) has not disturbed the conviction that those cases were rightly decided, I think that in some respects the reasons given for the judgments cannot be sustained. Instead of holding that the Anti-Trust Act included all contracts, reasonable or unreasonable, in restraint of interstate trade, the ruling should have been that the contracts there presented were unreasonable restraints of interstate trade, and as such within the scope of the act. That act, as appears from its title, was leveled at only "unlawful restraints and monopolies." Congress did not intend to reach and destroy those minor contracts in partial restraint of trade which the long course of decisions at common law had affirmed were reasonable and ought to be upheld. The purpose rather was to place a statutory prohibition with prescribed penalties and remedies upon those contracts which were in direct restraint of trade, unreasonable and against public policy. Whenever a departure from common law rules and definitions is claimed, the purpose to make the departure should be clearly shown. Such a purpose does not appear and such a departure was not intended.

Further, the general language of the act is also limited by the power which each individual has to manage his own property and

determine the place and manner of its investment. Freedom of action in these respects is among the inalienable rights of every citizen. If, applying this thought to the present case, it appeared that Mr. Hill was the owner of a majority of the stock in the Great Northern Railway Company he could not by any act of Congress be deprived of the right of investing his surplus means in the purchase of stock of the Northern Pacific Railway Company, although such purchase might tend to vest in him through that ownership a control over both companies. In other words, the right, which all other citizens had, of purchasing Northern Pacific stock could not be denied to him by Congress because of his ownership of stock in the Great Northern Company. Such was the ruling in *Pearsall* v. *Great Northern Railway*, 161 U.S. 646, in which this court said (p. 671), in reference to the right of the stockholders of the Great Northern Company to purchase the stock of the Northern Pacific Railway Company: "Doubtless these stockholders could lawfully acquire by individual purchases a majority, or even the whole of the stock of the reorganized company, and thus possibly obtain its ultimate control; but the companies would still remain separate corporations with no interests, as such, in common."

But no such investment by a single individual of his means is here presented. There was a combination by several individuals separately owning stock in two competing railroad companies to place the control of both in a single corporation. The purpose to combine and by combination destroy competition existed before the organization of the corporation, the Securities Company. That corporation, though nominally having a capital stock of $400,000,-000, had no means of its own; $30,000 in cash was put into its treasury, but simply for the expenses of organization. The organizers might just as well have made the nominal stock a thousand millions as four hundred, and the corporation would have been no richer or poorer. A corporation, while by fiction of law recognized for some purposes as a person and for purposes of jurisdiction as a citizen, is not endowed with the inalienable rights of a natural person. It is an artificial person, created and existing only for the convenient transaction of business. In this case it was a mere instrumentality by which separate railroad properties were combined under one control. That combination is as direct a restraint of trade by destroying competition as the appointment of a committee to regulate rates. The prohibition of such a combination is not at all inconsistent with the right of an individual to purchase stock. The transfer of stock to the Securities Company was a mere incident, the manner in which the combination to destroy competition and thus unlawfully restrain trade was carried out.

If the parties interested in these two railroad companies can, through the instrumentality of a holding corporation, place both

under one control, then in like manner, as was conceded on the argument by one of the counsel for the appellants, could the control of all the railroad companies in the country be placed in a single corporation. Nor need this arrangement for control stop with what has already been done. The holders of $201,000,000 of stock in the Northern Securities Company might organize another corporation to hold their stock in that company, and the new corporation holding the majority of the stock in the Northern Securities Company and acting in obedience to the wishes of a majority of its stockholders would control the action of the Securities Company and through it the action of the two railroad companies, and this process might be extended until a single corporation whose stock was owned by three or four parties would be in practical control of both roads, or, having before us the possibilities of combination, the control of the whole transportation system of the country. I cannot believe that to be a reasonable or lawful restraint of trade.

It must also be remembered that under present conditions a single railroad is, if not a legal, largely a practical, monopoly, and the arrangement by which the control of these two competing roads was merged in a single corporation broadens and extends such monopoly. I cannot look upon it as other than an unreasonable combination in restraint of interstate commerce — one in conflict with state law and within the letter and spirit of the statute and the power of Congress. Therefore I concur in the judgment of affirmance.

I have felt constrained to make these observations for fear that the broad and sweeping language of the opinion of the court might tend to unsettle legitimate business enterprises, stifle or retard wholesome business activities, encourage improper disregard of reasonable contracts and invite unnecessary litigation.

The decree affirmed enjoined the Northern Securities Company from voting the stock which it held in the two railroad corporations; and enjoined the two railroad corporations from paying any dividends on such stock to the Northern Securities Company. But it permitted the Northern Securities Company to transfer such stock to the holders of its own stock which had been issued in exchange or payment for the railroad stocks.

Mr. Justice WHITE dissented. He was of opinion that Congress had no constitutional power to regulate the ownership of stock in state corporations, even if such corporations may be in part engaged in interstate commerce. In the course of his opinion he said: "It has been decided by this court that, as the Anti-Trust Act forbids any restraint, it therefore embraces even reasonable contracts or agreements."

Chief Justice FULLER, Mr. Justice PECKHAM, and Mr. Justice HOLMES concurred in this dissent.

Mr. Justice HOLMES, dissenting.

The question to be decided is whether, under the act of July 2, 1890, chap. 647, 26 Stat. 209, it is unlawful, at any stage of the process, if several men unite to form a corporation for the purpose of buying more than half the stock of each of two competing interstate railroad companies, if they form the corporation, and the corporation buys the stock. I will suppose further that every step is taken, from the beginning, with the single intent of ending competition between the companies. I make this addition not because it may not be and is not disputed but because, as I shall try to show, it is totally unimportant under any part of the statute with which we have to deal.

The statute of which we have to find the meaning is a criminal statute. The two sections on which the Government relies both make certain acts crimes. That is their immediate purpose and that is what they say. It is vain to insist that this is not a criminal proceeding. The words cannot be read one way in a suit which is to end in fine and imprisonment and another way in one which seeks an injunction. The construction which is adopted in this case must be adopted in one of the other sort. I am no friend of artificial interpretations because a statute is of one kind rather than another, but all agree that before a statute is to be taken to punish that which always has been lawful it must express its intent in clear words. So I say we must read the words before us as if the question were whether two small exporting grocers should go to jail.

Again the statute is of a very sweeping and general character. It hits "every" contract or combination of the prohibited sort, great or small, and "every" person who shall monopolize or attempt to monopolize, in the sense of the act, "any part" of the trade or commerce among the several States. There is a natural inclination to assume that it was directed against certain great combinations and to read it in that light. It does not say so. On the contrary, it says "every," and "any part." Still less was it directed specially against railroads. There even was a reasonable doubt whether it included railroads until the point was decided by this court.

Finally, the statute must be construed in such a way as not merely to save its constitutionality but, so far as is consistent with a fair interpretation, not to raise grave doubts on that score. I assume, for the purposes of discussion, although it would be a great and serious step to take, that in some case that seemed to it to need heroic measures, Congress might regulate not only commerce, but instruments of commerce or contracts the bearing of which

upon commerce would be only indirect. But it is clear that the mere fact of an indirect effect upon commerce not shown to be certain and very great, would not justify such a law. The point decided in *United States* v. *E. C. Knight Co.*, 156 U.S. 1, 17, was that "the fact that trade or commerce might be indirectly affected was not enough to entitle complainants to a decree." Commerce depends upon population, but Congress could not, on that ground, undertake to regulate marriage and divorce. If the act before us is to be carried out according to what seems to me the logic of the argument for the Government, which I do not believe that it will be, I can see no part of the conduct of life with which on similar principles Congress might not interfere.

This act is construed by the Government to affect the purchasers of shares in two railroad companies because of the effect it may have, or, if you like, is certain to have, upon the competition of these roads. If such a remote result of the exercise of an ordinary incident of property and personal freedom is enough to make that exercise unlawful, there is hardly any transaction concerning commerce between the States that may not be made a crime by the finding of a jury or a court. The personal ascendency of one man may be such that it would give to his advice the effect of a command, if he owned but a single share in each road. The tendency of his presence in the stockholders' meeting might be certain to prevent competition, and thus his advice, if not his mere existence, become a crime.

I state these general considerations as matters which I should have to take into account before I could agree to affirm the decree appealed from, but I do not need them for my own opinion, because when I read the act I cannot feel sufficient doubt as to the meaning of the words to need to fortify my conclusion by any generalities. Their meaning seems to me plain on their face.

The first section makes "Every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several States, or with foreign nations," a misdemeanor, punishable by fine, imprisonment or both. Much trouble is made by substituting other phrases assumed to be equivalent, which then are reasoned from as if they were in the act. The court below argued as if maintaining competition were the expressed object of the act. The act says nothing about competition. I stick to the exact words used. The words hit two classes of cases, and only two — Contracts in restraint of trade and combinations or conspiracies in restraint of trade, and we have to consider what these respectively are. Contracts in restraint of trade are dealt with and defined by the common law. They are contracts with a stranger to the contractor's business (although in some cases carrying on a similar one), which wholly or partially restrict the freedom

of the contractor in carrying on that business as otherwise he would. The objection of the common law to them was primarily on the contractor's own account. The notion of monopoly did not come in unless the contract covered the whole of England. *Mitchel* v. *Reynolds*, 1 P. Wms. 181. Of course this objection did not apply to partnerships or other forms, if there were any, of substituting a community of interest where there had been competition. There was no objection to such combinations merely as in restraint of trade, or otherwise unless they amounted to a monopoly. Contracts in restraint of trade, I repeat, were contracts with strangers to the contractor's business, and the trade restrained was the contractor's own.

Combinations or conspiracies in restraint of trade, on the other hand, were combinations to keep strangers to the agreement out of the business. The objection to them was not an objection to their effect upon the parties making the contract, the members of the combination or firm, but an objection to their intended effect upon strangers to the firm and their supposed consequent effect upon the public at large. In other words, they were regarded as contrary to public policy because they monopolized or attempted to monopolize some portion of the trade or commerce of the realm. See *United States* v. *E. C. Knight Co.*, 156 U.S. 1. All that is added to the first section by § 2 is that like penalties are imposed upon every single person who, without combination, monopolizes or attempts to monopolize commerce among the States; and that the liability is extended to attempting to monopolize any part of such trade or commerce. It is more important as an aid to the construction of § 1 than it is on its own account. It shows that whatever is criminal when done by way of combination is equally criminal if done by a single man. That I am right in my interpretation of the words of § 1 is shown by the words "in the form of trust or otherwise." The prohibition was suggested by the trusts, the objection to which, as every one knows, was not the union of former competitors, but the sinister power exercised or supposed to be exercised by the combination in keeping rivals out of the business and ruining those who already were in. It was the ferocious extreme of competition with others, not the cessation of competition among the partners, that was the evil feared. Further proof is to be found in § 7, giving an action to any person injured in his business or property by the forbidden conduct. This cannot refer to the parties to the agreement and plainly means that outsiders who are injured in their attempt to compete with a trust or other similar combination may recover for it. *Montague & Co.* v. *Lowry*, 193 U.S. 38. How effective the section may be or how far it goes, is not material to my point. My general summary of the two classes of cases which the act affects is confirmed by the title, which is "An Act to protect Trade and Commerce against unlawful Restraints and Monopolies."

What I now ask is under which of the foregoing classes this case is supposed to come, and that question must be answered as definitely and precisely as if we were dealing with the indictments which logically ought to follow this decision. The provision of the statute against contracts in restraint of trade has been held to apply to contracts between railroads, otherwise remaining independent, by which they restricted their respective freedom as to rates. This restriction by contract with a stranger to the contractor's business is the ground of the decision in *United States* v. *Joint Traffic Association*, 171 U.S. 505, following and affirming *United States* v. *Trans-Missouri Freight Association*, 166 U.S. 290. I accept those decisions absolutely, not only as binding upon me, but as decisions which I have no desire to criticize or abridge. But the provision has not been decided, and, it seems to me, could not be decided without perversion of plain language, to apply to an arrangement by which competition is ended through community of interest — an arrangement which leaves the parties without external restriction. That provision, taken alone, does not require that all existing competitions shall be maintained. It does not look primarily, if at all, to competition. It simply requires that a party's freedom in trade between the States shall not be cut down by contract with a stranger. So far as that phrase goes, it is lawful to abolish competition by any form of union. It would seem to me impossible to say that the words "every contract in restraint of trade is a crime punishable with imprisonment," would send the members of a partnership between, or a consolidation of, two trading corporations to prison — still more impossible to say that it forbade one man or corporation to purchase as much stock as he liked in both. Yet those words would have that effect if this clause of § 1 applies to the defendants here. For it cannot be too carefully remembered that that clause applies to "every" contract of the forbidden kind — a consideration which was the turning point of the *Trans-Missouri Freight Association's* case.

If the statute applies to this case it must be because the parties, or some of them, have formed, or because the Northern Securities Company is, a combination in restraint of trade among the States, or, what comes to the same thing in my opinion, because the defendants, or some or one of them, are monopolizing or attempting to monopolize some part of the commerce between the States. But the mere reading of those words shows that they are used in a limited and accurate sense. According to popular speech, every concern monopolizes whatever business it does, and if that business is trade between two States it monopolizes a part of the trade among the States. Of course the statute does not forbid that. It does not mean that all business must cease. A single railroad down a narrow valley or through a mountain gorge monopolizes all the railroad transportation through that valley or gorge. Indeed every railroad

monopolizes, in a popular sense, the trade of some area. Yet I suppose no one would say that the statute forbids a combination of men into a corporation to build and run such a railroad between the States.

I assume that the Minnesota charter of the Great Northern and the Wisconsin charter of the Northern Pacific both are valid. Suppose that, before either road was built, Minnesota, as part of a system of transportation between the States, had created a railroad company authorized singly to build all the lines in the States now actually built, owned or controlled by either of the two existing companies. I take it that that charter would have been just as good as the present one, even if the statutes which we are considering had been in force. In whatever sense it would have created a monopoly the present charter does. It would have been a large one, but the act of Congress makes no discrimination according to size. Size has nothing to do with the matter. A monopoly of "any part" of commerce among the States is unlawful. The supposed company would have owned lines that might have been competing — probably the present one does. But the act of Congress will not be construed to mean the universal disintegration of society into single men, each at war with all the rest, or even the prevention of all further combinations for a common end.

There is a natural feeling that somehow or other the statute meant to strike at combinations great enough to cause just anxiety on the part of those who love their country more than money, while it viewed such little ones as I have supposed with just indifference. This notion, it may be said, somehow breathes from the pores of the act, although it seems to be contradicted in every way by the words in detail. And it has occurred to me that it might be that when a combination reached a certain size it might have attributed to it more of the character of a monopoly merely by virtue of its size than would be attributed to a smaller one. I am quite clear that it is only in connection with monopolies that size could play any part. But my answer has been indicated already. In the first place size in the case of railroads is an inevitable incident, and if it were an objection under the act, the Great Northern and the Northern Pacific already were too great and encountered the law. In the next place in the case of railroads it is evident that the size of the combination is reached for other ends than those which would make them monopolies. The combinations are not formed for the purpose of excluding others from the field. Finally, even a small railroad will have the same tendency to exclude others from its narrow area that great ones have to exclude others from a greater one, and the statute attacks the small monopolies as well as the great. The very words of the act make such a distinction impossible in this case and it has not been attempted in express terms.

If the charter which I have imagined above would have been good notwithstanding the monopoly, in a popular sense, which it created, one next is led to ask whether and why a combination or consolidation of existing roads, although in actual competition, into one company of exactly the same powers and extent, would be any more obnoxious to the law. Although it was decided in *Louisville & Nashville Railroad Co.* v. *Kentucky*, 161 U.S. 677, 701, that since the statute, as before, the States have the power to regulate the matter, it was said, in the argument, that such a consolidation would be unlawful, and it seems to me that the Attorney General was compelled to say so in order to maintain his case. But I think that logic would not let him stop there, or short of denying the power of a State at the present time to authorize one company to construct and own two parallel lines that might compete. The monopoly would be the same as if the roads were consolidated after they had begun to compete — and it is on the footing of monopoly that I now am supposing the objection made. But to meet the objection to the prevention of competition at the same time, I will suppose that three parties apply to a State for charters; one for each of two new and possibly competing lines respectively, and one for both of these lines, and that the charter is granted to the last. I think that charter would be good, and I think the whole argument to the contrary rests on a popular instead of an accurate and legal conception of what the word "monopolize" in the statute means. I repeat, that in my opinion there is no attempt to monopolize, and what, as I have said, in my judgment amounts to the same thing, that there is no combination in restraint of trade, until something is done with the intent to exclude strangers to the combination from competing with it in some part of the business which it carries on.

Unless I am entirely wrong in my understanding of what a "combination in restraint of trade" means, then the same monopoly may be attempted and effected by an individual, and is made equally illegal in that case by § 2. But I do not expect to hear it maintained that Mr. Morgan could be sent to prison for buying as many shares as he liked of the Great Northern and the Northern Pacific, even if he bought them both at the same time and got more than half the stock of each road.

There is much that was mentioned in argument which I pass by. But in view of the great importance attached by both sides to the supposed attempt to suppress competition, I must say a word more about that. I said at the outset that I should assume, and I do assume, that one purpose of the purchase was to suppress competition between the two roads. I appreciate the force of the argument that there are independent stockholders in each; that it cannot be presumed that the respective boards of directors will propose any illegal act; that if they should they could be restrained, and that all

that has been done as yet is too remote from the illegal result to be classed even as an attempt. Not every act done in furtherance of an unlawful end is an attempt or contrary to the law. There must be a certain nearness to the result. It is a question of proximity and degree. *Commonwealth* v. *Peaslee*, 177 Massachusetts, 267, 272. So, as I have said, is the amenability of acts in furtherance of interference with commerce among the States to legislation by Congress. So, according to the intimation of this court, is the question of liability under the present statute. *Hopkins* v. *United States*, 171 U.S. 578; *Anderson* v. *United States*, 171 U.S. 604. But I assume further, for the purposes of discussion, that what has been done is near enough to the result to fall under the law, if the law prohibits that result, although that assumption very nearly if not quite contradicts the decision in *United States* v. *E. C. Knight Co.*, 156 U.S. 1. But I say that the law does not prohibit the result. If it does it must be because there is some further meaning than I have yet discovered in the words "combinations in restraint of trade." I think that I have exhausted the meaning of those words in what I have already said. But they certainly do not require all existing competitions to be kept on foot, and, on the principle of the *Trans-Missouri Freight Association's* case, invalidate the continuance of old contracts by which former competitors united in the past.

A partnership is not a contract or combination in restraint of trade between the partners unless the well known words are to be given a new meaning invented for the purposes of this act. It is true that the suppression of competition was referred to in *United States* v. *Trans-Missouri Freight Association*, 166 U.S. 290, but, as I have said, that was in connection with a contract with a stranger to the defendant's business — a true contract in restraint of trade. To suppress competition in that way is one thing, to suppress it by fusion is another. The law, I repeat, says nothing about competition, and only prevents its suppression by contracts or combinations in restraint of trade, and such contracts or combinations derive their character as restraining trade from other features than the suppression of competition alone. To see whether I am wrong, the illustrations put in the argument are of use. If I am, then a partnership between two stage drivers who had been competitors in driving across a state line, or two merchants once engaged in rival commerce among the States whether made after or before the act, if now continued, is a crime. For, again I repeat, if the restraint on the freedom of the members of a combination caused by their entering into partnership is a restraint of trade, every such combination, as well the small as the great, is within the act.

In view of my interpretation of the statute I do not go further into the question of the power of Congress. That has been dealt with by my brother WHITE and I concur in the main with his views.

I am happy to know that only a minority of my brethren adopt an interpretation of the law which in my opinion would make eternal the *bellum omnium contra omnes* and disintegrate society so far as it could into individual atoms. If that were its intent I should regard calling such a law a regulation of commerce as a mere pretense. It would be an attempt to reconstruct society. I am not concerned with the wisdom of such an attempt, but I believe that Congress was not entrusted by the Constitution with the power to make it and I am deeply persuaded that it has not tried.

Chief Justice FULLER, Mr. Justice WHITE, and Mr. Justice PECKHAM concurred in this dissent.

NOTE. — In *United States* v. *Union Pacific R.R. Co.*, 226 U.S. 61, the court held that the Anti-Trust Act was violated where the Union Pacific R.R. Co. acquired a dominating influence over the conduct of the business of the Southern Pacific Co., a competing railroad company, through the ownership, by a corporation controlled by the Union Pacific, of 46 per cent of the stock of the Southern Pacific. In the course of its opinion the court said (p. 88): —

"It is urged that this competitive traffic was infinitesimal when compared with the gross amount of the business transacted by both roads, and so small as only to amount to that incidental restraint of trade which ought not to be held to be within the law; but we think the testimony amply shows that, while these roads did a great deal of business for which they did not compete and that the competitive business was a comparatively small part of the sum total of all traffic, state and interstate, carried over them, nevertheless such competing traffic was large in volume, amounting to many millions of dollars. Before the transfer of the stock this traffic was the subject of active competition between these systems, but by reason of the power arising from such transfer it has since been placed under a common control. It was by no means a negligible part, but a large and valuable part, of interstate commerce which was thus directly affected."

In *United States* v. *Union Pacific R.R. Co.*, 226 U.S. 470, the court held that a sale of the stock of the Southern Pacific to the shareholders of the Union Pacific, substantially in proportion to their respective holdings (or a distribution thereof, by way of a dividend) would not constitute a disposition of the shares in compliance with the opinion of the court reported in 226 U.S. 61.

SWIFT & CO. *v.* UNITED STATES.

196 U.S. 375. 1905.

MR. JUSTICE HOLMES. This is an appeal from a decree of the Circuit Court, on demurrer, granting an injunction against the appellants' commission of alleged violations of the act of July 2, 1890, chap. 647, 26 Stat. 209, "to protect trade and commerce against unlawful restraints and monopolies." It will be necessary to consider both the bill and the decree. The bill is brought against a number of corporations, firms and individuals of different States and makes the following allegations: 1. The defendants (appellants) are engaged in the business of buying live stock at the stock yards in Chicago, Omaha, St. Joseph, Kansas City, East St. Louis and St. Paul, and slaughtering such live stock at their respective plants in places named, in different States, and converting the live stock into fresh meat for human consumption. 2. The defendants "are also engaged in the business of selling such fresh meats, at the several places where they are so prepared, to dealers and consumers in divers States and Territories of the said United States other than those wherein the said meats are so prepared and sold as aforesaid, and in the District of Columbia, and in foreign countries, and shipping the same meats, when so sold from the said places of their preparation, over the several lines of transportation of the several railroad companies serving the same as common carriers, to such dealers and consumers, pursuant to such sales." 3. The defendants also are engaged in the business of shipping such fresh meats to their respective agents at the principal markets in other States, etc., for sale by those agents in those markets to dealers and consumers. 4. The defendants together control about six-tenths of the whole trade and commerce in fresh meats among the States, Territories and District of Columbia, and, 5, but for the acts charged would be in free competition with one another.

6. In order to restrain competition among themselves as to the purchase of live stock, defendants have engaged in, and intend to continue, a combination for requiring and do and will require their respective purchasing agents at the stock yards mentioned, where defendants buy their live stock (the same being stock produced and owned principally in other States and shipped to the yards for sale), to refrain from bidding against each other, "except perfunctorily and without good faith," and by this means compelling the owners of such stock to sell at less prices than they would receive if the bidding really was competitive.

7. For the same purposes the defendants combine to bid up, through their agents, the prices of live stock for a few days at a time, "so that the market reports will show prices much higher than the

state of the trade will warrant," thereby inducing stock owners in other States to make large shipments to the stock yards to their disadvantage.

8. For the same purposes, and to monopolize the commerce protected by the statute, the defendants combine "to arbitrarily, from time to time raise, lower, and fix prices, and to maintain uniform prices at which they will sell" to dealers throughout the States. This is effected by secret periodical meetings, where are fixed prices to be enforced until changed at a subsequent meeting. The prices are maintained directly, and by collusively restricting the meat shipped by the defendants, whenever conducive to the result, by imposing penalties for deviations, by establishing a uniform rule for the giving of credit to dealers, etc., and by notifying one another of the delinquencies of such dealers and keeping a black list of delinquents, and refusing to sell meats to them.

9. The defendants also combine to make uniform charges for cartage for the delivery of meats sold to dealers and consumers in the markets throughout the States, etc., shipped to them by the defendants through the defendants' agents at the markets, when no charges would have been made but for the combination.

10. Intending to monopolize the said commerce and to prevent competition therein, the defendants "have all and each engaged in and will continue" arrangements with the railroads whereby the defendants received, by means of rebates and other devices, rates less than the lawful rates for transportation, and were exclusively to enjoy and share this unlawful advantage to the exclusion of competition and the public. By force of the consequent inability of competitors to engage or continue in such commerce, the defendants are attempting to monopolize, have monopolized, and will monopolize the commerce in live stock and fresh meats among the States and Territories, and with foreign countries, and, 11, the defendants are, and have been in conspiracy with each other, with the railroad companies and others unknown, to obtain a monopoly of the supply and distribution of fresh meats throughout the United States, etc. And to that end defendants artificially restrain the commerce and put arbitrary regulations in force affecting the same from the shipment of the live stock from the plains to the final distribution of the meats to the consumers.

To sum up the bill more shortly, it charges a combination of a dominant proportion of the dealers in fresh meat throughout the United States not to bid against each other in the live stock markets of the different States, to bid up prices for a few days in order to induce the cattle men to send their stock to the stock yards, to fix prices at which they will sell, and to that end to restrict shipments of meat when necessary, to establish a uniform rule of credit to dealers and to keep a black list, to make uniform and improper charges for

cartage, and finally, to get less than lawful rates from the railroads to the exclusion of competitors. It is true that the last charge is not clearly stated to be a part of the combination. But as it is alleged that the defendants have each and all made arrangements with the railroads, that they were exclusively to enjoy the unlawful advantage, and that their intent in what they did was to monopolize the commerce and to prevent competition, and in view of the general allegation to which we shall refer, we think that we have stated correctly the purport of the bill. It will be noticed further that the intent to monopolize is alleged for the first time in the eighth section of the bill as to raising, lowering and fixing prices. In the earlier sections, the intent alleged is to restrain competition among themselves. But after all the specific charges there is a general allegation that the defendants are conspiring with one another, the railroads and others, to monopolize the supply and distribution of fresh meats throughout the United States, etc., as has been stated above, and it seems to us that this general allegation of intent colors and applies to all the specific charges of the bill.

Although the combination alleged embraces restraint and monopoly of trade within a single State, its effect upon commerce among the States is not accidental, secondary, remote or merely probable. On the allegations of the bill the latter commerce no less, perhaps even more, than commerce within a single State is an object of attack. See *Leloup* v. *Port of Mobile*, 127 U.S. 640, 647; *Crutcher* v. *Kentucky*, 141 U.S. 47, 59; *Allen* v. *Pullman Co.*, 191 U.S. 171, 179, 180. Moreover, it is a direct object, it is that for the sake of which the several specific acts and courses of conduct are done and adopted. Therefore the case is not like *United States* v. *E. C. Knight Co.*, 156 U.S. 1, where the subject matter of the combination was manufacture and the direct object monopoly of manufacture within a State. However likely monopoly of commerce among the States in the article manufactured was to follow from the agreement it was not a necessary consequence nor a primary end. Here the subject matter is sales and the very point of the combination is to restrain and monopolize commerce among the States in respect of such sales. The two cases are near to each other, as sooner or later always must happen where lines are to be drawn, but the line between them is distinct. *Montague & Co.* v. *Lowry*, 193 U.S. 38.

So, again, the line is distinct between this case and *Hopkins* v. *United States*, 171 U.S. 578. All that was decided there was that the local business of commission merchants was not commerce among the States, even if what the brokers were employed to sell was an object of such commerce. The brokers were not like the defendants before us, themselves the buyers and sellers. They only furnished certain facilities for the sales. Therefore, there again the effects of the combination of brokers upon the commerce was only indirect and

not within the act. Whether the case would have been different if the combination had resulted in exorbitant charges, was left open. In *Anderson* v. *United States*, 171 U.S. 604, the defendants were buyers and sellers at the stock yards, but their agreement was merely not to employ brokers, or to recognize yard-traders, who were not members of their association. Any yard-trader could become a member of the association on complying with the conditions, and there was said to be no feature of monopoly in the case. It was held that the combination did not directly regulate commerce between the States, and, being formed with a different intent, was not within the act. The present case is more like *Montague & Co.* v. *Lowry*, 193 U.S. 38.

For the foregoing reasons we are of opinion that the carrying out of the scheme alleged, by the means set forth, properly may be enjoined, and that the bill cannot be dismissed.

So far it has not been necessary to consider whether the facts charged in any single paragraph constitute commerce among the States or show an interference with it. There can be no doubt, we apprehend, as to the collective effect of all the facts, if true, and if the defendants entertain the intent alleged. We pass now to the particulars, and will consider the corresponding parts of the injunction at the same time. The first question arises on the sixth section. That charges a combination of independent dealers to restrict the competition of their agents when purchasing stock for them in the stock yards. The purchasers and their slaughtering establishments are largely in different States from those of the stock yards, and the sellers of the cattle, perhaps it is not too much to assume, largely in different States from either. The intent of the combination is not merely to restrict competition among the parties, but, as we have said, by force of the general allegation at the end of the bill, to aid in an attempt to monopolize commerce among the States.

It is said that this charge is too vague and that it does not set forth a case of commerce among the States. Taking up the latter objection first, commerce among the States is not a technical legal conception, but a practical one, drawn from the course of business. When cattle are sent for sale from a place in one State, with the expectation that they will end their transit, after purchase, in another, and when in effect they do so, with only the interruption necessary to find a purchaser at the stock yards, and when this is a typical, constantly recurring course, the current thus existing is a current of commerce among the States, and the purchase of the cattle is a part and incident of such commerce. What we say is true at least of such a purchase by residents in another State from that of the seller and of the cattle. And we need not trouble ourselves at this time as to whether the statute could be escaped by any arrangement as to the place where the sale in point of law is consummated. See *Nor-*

folk & Western Ry. v. *Sims,* 191 U.S. 441. But the sixth section of the bill charges an interference with such sales, a restraint of the parties by mutual contract and a combination not to compete in order to monopolize. It is immaterial if the section also embraces domestic transactions.

It should be added that the cattle in the stock yard are not at rest even to the extent that was held sufficient to warrant taxation in *American Steel & Wire Co.* v. *Speed,* 192 U.S. 500. But it may be that the question of taxation does not depend upon whether the article taxed may or may not be said to be in the course of commerce between the States, but depends upon whether the tax so far affects that commerce as to amount to a regulation of it. The injunction against taking part in a combination, the effect of which will be a restraint of trade among the States by directing the defendants' agents to refrain from bidding against one another at the sales of live stock, is justified so far as the subject matter is concerned.

The injunction, however, refers not to trade among the States in cattle, concerning which there can be no question of original packages, but to trade in fresh meats, as the trade forbidden to be restrained, and it is objected that the trade in fresh meats described in the second and third sections of the bill is not commerce among the States, because the meat is sold at the slaughtering places, or when sold elsewhere may be sold in less than the original packages. But the allegations of the second section, even if they import a technical passing of title at the slaughtering places, also import that the sales are to persons in other States, and that the shipments to other States are part of the transaction — "pursuant to such sales" — and the third section imports that the same things which are sent to agents are sold by them, and sufficiently indicates that some at least of the sales are of the original packages. Moreover, the sales are by persons in one State to persons in another. But we do not mean to imply that the rule which marks the point at which state taxation or regulation becomes permissible necessarily is beyond the scope of interference by Congress in cases where such interference is deemed necessary for the protection of commerce among the States. Nor do we mean to intimate that the statute under consideration is limited to that point. Beyond what we have said above, we leave those questions as we find them. They were touched upon in the *Northern Securities Company's Case,* 193 U.S. 197.

STANDARD OIL CO. *v.* UNITED STATES.

221 U.S. 1. 1911.

THE Standard Oil Company of Ohio was formed in 1870, and acquired the assets of three separate partnerships theretofore engaged in the business of refining crude oil and shipping its products in interstate commerce. The former partners became its stockholders. Thereafter various properties were acquired either by the said corporation, or by trustees acting in behalf of the stockholders of said corporation, with the result that said corporation and trustees came to control a great part — alleged by the Government to be 90 per cent — of the business in the United States of producing, shipping, refining and selling petroleum and its products.

In 1882 the stock of the Standard Oil Company of Ohio, and the properties held by the said trustees, were transferred to certain trustees, who issued certificates of beneficial interest. The trustees thereafter acquired other properties having a value in the petroleum business. *Quo warranto* proceedings were commenced in Ohio against the Standard Oil Company of Ohio which resulted in the entry by the Supreme Court of Ohio, on March 2, 1892, of a decree adjudging the trust agreement to be void, not only because the Standard Oil Company of Ohio was a party to the same, but also because the agreement in and of itself was in restraint of trade and amounted to the creation of an unlawful monopoly. In 1897, the Attorney General of Ohio instituted contempt proceedings in the *quo warranto* case based upon the claim that the trust had not been dissolved as required by the decree in that case.

In 1899 the stock of the Standard Oil Company of New Jersey was increased from $10,000,000 to $110,000,000, and it acquired the properties formerly held by the said trustees.

The government alleged that improper means had been used to ensure success in the conduct of the business of the Standard Oil Company of Ohio, the Standard Oil Trustees, and the Standard Oil Company of New Jersey. It enumerated: rebates, preferences and other discriminatory practises in favor of the combination by railroad companies; restraint and monopolization by control of pipe lines, and unfair practises against competing pipe lines; contracts with competitors in restraint of trade; unfair methods of competition, such as local price cutting at the points where necessary to suppress competition; espionage of the business of competitors, the operation of bogus independent companies, and payment of rebates on oil, with the like intent; the division of the United States into districts and the limiting of the operations of the various subsidiary corporations as to such districts so that competition in the sale of

petroleum products between such corporations had been entirely eliminated and destroyed.

In its answer, the Standard Oil Company of New Jersey denied that a combination of *independent or competing* concerns or corporations was affected either by the formation of the Trust in 1882, or by its own acquisitions in 1899.

The court below entered a decree which required the Standard Oil Company of New Jersey to transfer back, to the stockholders of the various subsidiary corporations, the stocks which had been turned over to it in exchange for its stock.

MR. CHIEF JUSTICE WHITE. The debates [in Congress] show that doubt as to whether there was a common law of the United States which governed the subject in the absence of legislation was among the influences leading to the passage of the act. They conclusively show, however, that the main cause which led to the legislation was the thought that it was required by the economic condition of the times, that is, the vast accumulation of wealth in the hands of corporations and individuals, the enormous development of corporate organization, the facility for combination which such organizations afforded, the fact that the facility was being used, and that combinations known as trusts were being multiplied, and the widespread impression that their power had been and would be exerted to oppress individuals and injure the public generally. Although debates may not be used as a means for interpreting a statute (*United States* v. *Trans-Missouri Freight Association*, 166 U.S. 318, and cases cited) that rule in the nature of things is not violated by resorting to debates as a means of ascertaining the environment at the time of the enactment of a particular law, that is, the history of the period when it was adopted.

There can be no doubt that the sole subject with which the first section deals is restraint of trade as therein contemplated, and that the attempt to monopolize and monopolization is the subject with which the second section is concerned. It is certain that those terms, at least in their rudimentary meaning, took their origin in the common law, and were also familiar in the law of this country prior to and at the time of the adoption of the act in question.

We shall endeavor then, first to seek their meaning, not by indulging in an elaborate and learned analysis of the English law and of the law of this country, but by making a very brief reference to the elementary and indisputable conceptions of both the English and American law on the subject prior to the passage of the Anti-Trust Act.

a. It is certain that at a very remote period the words "contract in restraint of trade" in England came to refer to some voluntary restraint put by contract by an individual on his right to carry on his trade or calling. Originally all such contracts were considered to

be illegal, because it was deemed they were injurious to the public as well as to the individuals who made them. In the interest of the freedom of individuals to contract this doctrine was modified so that it was only when a restraint by contract was so general as to be coterminous with the kingdom that it was treated as void. That is to say, if the restraint was partial in its operation and was otherwise reasonable the contract was held to be valid.

b. Monopolies were defined by Lord COKE as follows: —

"'A monopoly is an institution, or allowance by the king by his grant, commission, or otherwise to any person or persons, bodies politic or corporate, of or for the sole buying, selling, making, working, or using of anything, whereby any person or persons, bodies politic or corporate, are sought to be restrained of any freedom or liberty that they had before, or hindered in their lawful trade.' (3 Inst. 181, chap. 85.)"

Hawkins thus defined them: —

"'A monopoly is an allowance by the king to a particular person or persons of the sole buying, selling, making, working, or using of anything whereby the subject in general is restrained from the freedom of manufacturing or trading which he had before.' (Hawk. P.C. bk. 1, chap. 29.)"

The frequent granting of monopolies and the struggle which led to a denial of the power to create them, that is to say, to the establishment that they were incompatible with the English constitution is known to all and need not be reviewed. The evils which led to the public outcry against monopolies and to the final denial of the power to make them may be thus summarily stated: 1. The power which the monopoly gave to the one who enjoyed it to fix the price and thereby injure the public; 2. The power which it engendered of enabling a limitation on production; and, 3. The danger of deterioration in quality of the monopolized article which it was deemed was the inevitable resultant of the monopolistic control over its production and sale. As monopoly as thus conceived embraced only a consequence arising from an exertion of sovereign power, no express restrictions or prohibitions obtained against the creation by an individual of a monopoly as such. But as it was considered, at least so far as the necessaries of life were concerned, that individuals by the abuse of their right to contract might be able to usurp the power arbitrarily to enhance prices, one of the wrongs arising from monopoly, it came to be that laws were passed relating to offenses such as forestalling, regrating and engrossing by which prohibitions were placed upon the power of individuals to deal under such circumstances and conditions as, according to the conception of the times, created a presumption that the dealings were not simply the honest exertion of one's right to contract for his own benefit unaccompanied by a wrongful motive to injure others, but were the consequence of a

contract or course of dealing of such a character as to give rise to the presumption of an intent to injure others through the means, for instance, of a monopolistic increase of prices. This is illustrated by the definition of engrossing found in the statute, 5 and 6 Edw. VI, chap. 14, as follows: —

"Whatsoever person or persons . . . shall engross or get into his or their hands by buying, contracting, or promise-taking, other than by demise, grant, or lease of land, or tithe, any corn growing in the fields, or any other corn or grain, butter, cheese, fish, or other dead victual, whatsoever, within the realm of England, to the intent to sell the same again, shall be accepted, reputed, and taken an unlawful engrosser or engrossers."

As by the statutes providing against engrossing the quantity engrossed was not required to be the whole or a proximate part of the whole of an article, it is clear that there was a wide difference between monopoly and engrossing, etc. But as the principal wrong which it was deemed would result from monopoly, that is, an enhancement of the price, was the same wrong to which it was thought the prohibited engrossment would give rise, it came to pass that monopoly and engrossing were regarded as virtually one and the same thing. In other words, the prohibited act of engrossing because of its inevitable accomplishment of one of the evils deemed to be engendered by monopoly, came to be referred to as being a monopoly or constituting an attempt to monopolize. Thus POLLEXFEN, in his argument in *East India Company* v. *Sandys*, Skin. 165, 169, said: —

"By common law, he said that trade is free, and for that cited 3 Inst. 81; F.B. 65; 1 Roll. 4; that the common law is as much against 'monopoly' as 'engrossing'; and that they differ only, that a 'monopoly' is by patent from the king, the other is by the act of the subject between party and party; but that the mischiefs are the same from both, and there is the same law against both. Moore, 673; 11 Rep. 84. The sole trade of anything is 'engrossing' *ex rei natura*, for whosoever hath the sole trade of buying and selling hath 'engrossed' that trade; and whosoever hath the sole trade to any country, hath the sole trade of buying and selling the produce of that country, at his own price, which is an 'engrossing.'"

And by operation of the mental process which led to considering as a monopoly acts which although they did not constitute a monopoly were thought to produce some of its baneful effects, so also because of the impediment or burden to the due course of trade which they produced, such acts came to be referred to as in restraint of trade. This is shown by my Lord COKE's definition of monopoly as being "an institution or allowance . . . whereby any person or persons, bodies politic or corporate, are sought to be restrained of any freedom or liberty that they had before or hindered in their law-

ful trade." It is illustrated also by the definition which Hawkins gives of monopoly wherein it is said that the effect of monopoly is to restrain the citizen "from the freedom of manufacturing or trading which he had before." And see especially the opinion of PARKER, C.J., in *Mitchel* v. *Reynolds*, (1711) 1 P. Williams, 181, where a classification is made of monopoly which brings it generically within the description of restraint of trade.

Generalizing these considerations, the situation is this: 1. That by the common law monopolies were unlawful because of their restriction upon individual freedom of contract and their injury to the public. 2. That as to necessaries of life the freedom of the individual to deal was restricted where the nature and character of the dealing was such as to engender the presumption of intent to bring about at least one of the injuries which it was deemed would result from monopoly, that is, an undue enhancement of price. 3. That to protect the freedom of contract of the individual not only in his own interest, but principally in the interest of the common weal, a contract of an individual by which he put an unreasonable restraint upon himself as to carrying on his trade or business was void. And that at common law the evils consequent upon engrossing, etc., caused those things to be treated as coming within monopoly and sometimes to be called monopoly and the same considerations caused monopoly, because of its operation and effect, to be brought within and spoken of generally as impeding the due course of or being in restraint of trade.

From the development of more accurate economic conceptions and the changes in conditions of society it came to be recognized that the acts prohibited by the engrossing, forestalling, etc., statutes did not have the harmful tendency which they were presumed to have when the legislation concerning them was enacted, and therefore did not justify the presumption which had previously been deduced from them, but, on the contrary, such acts tended to fructify and develop trade. See the statutes of 12th George III, chap. 71, enacted in 1772, and statute of 7 and 8 Victoria, chap. 24, enacted in 1844, repealing the prohibitions against engrossing, forestalling, etc., upon the express ground that the prohibited acts had come to be considered as favorable to the development of and not in restraint of trade. It is remarkable that nowhere at common law can there be found a prohibition against the creation of monopoly by an individual. This would seem to manifest, either consciously, or intuitively, a profound conception as to the inevitable operation of economic forces and the equipoise or balance in favor of the protection of the rights of individuals which resulted. That is to say, as it was deemed that monopoly in the concrete could only arise from an act of sovereign power, and, such sovereign power being restrained, prohibitions as to individuals were directed, not against the creation of monopoly, but were only applied to such acts in relation to particular

subjects as to which it was deemed, if not restrained, some of the consequences of monopoly might result. After all, this was but an instinctive recognition of the truisms that the course of trade could not be made free by obstructing it, and that an individual's right to trade could not be protected by destroying such right.

From the review just made it clearly results that outside of the restrictions resulting from the want of power in an individual to voluntarily and unreasonably restrain his right to carry on his trade or business and outside of the want of right to restrain the free course of trade by contracts or acts which implied a wrongful purpose, freedom to contract and to abstain from contracting and to exercise every reasonable right incident thereto became the rule in the English law. The scope and effect of this freedom to trade and contract is clearly shown by the decision in *Mogul Steamship Co.* v. *McGregor*, (1892) A.C. 25. While it is true that the decision of the House of Lords in the case in question was announced shortly after the passage of the Anti-Trust Act, it serves reflexly to show the exact state of the law in England at the time the Anti-Trust statute was enacted.

In this country also the acts from which it was deemed there resulted a part if not all of the injurious consequences ascribed to monopoly, came to be referred to as a monopoly itself. In other words, here as had been the case in England, practical common sense caused attention to be concentrated not upon the theoretically correct name to be given to the condition or acts which gave rise to a harmful result, but to the result itself and to the remedying of the evils which it produced. The statement just made is illustrated by an early statute of the Province of Massachusetts, that is, chap. 31 of the laws of 1778–1779, by which monopoly and forestalling were expressly treated as one and the same thing.

It is also true that while the principles concerning contracts in restraint of trade, that is, voluntary restraint put by a person on his right to pursue his calling, hence only operating subjectively, came generally to be recognized in accordance with the English rule, it came moreover to pass that contracts or acts which it was considered had a monopolistic tendency, especially those which were thought to unduly diminish competition and hence to enhance prices — in other words, to monopolize — came also in a generic sense to be spoken of and treated as they had been in England, as restricting the due course of trade, and therefore as being in restraint of trade. The dread of monopoly as an emanation of governmental power, while it passed at an early date out of mind in this country, as a result of the structure of our Government, did not serve to assuage the fear as to the evil consequences which might arise from the acts of individuals producing or tending to produce the consequences of monopoly. It resulted that treating such acts as we have said as amounting to monopoly, sometimes constitutional restrictions, again

legislative enactments or judicial decisions, served to enforce and illustrate the purpose to prevent the occurrence of the evils recognized in the mother country as consequent upon monopoly, by providing against contracts or acts of individuals or combinations of individuals or corporations deemed to be conducive to such results.

It will be found that as modern conditions arose the trend of legislation and judicial decision came more and more to adapt the recognized restrictions to new manifestations of conduct or of dealing which it was thought justified the inference of intent to do the wrongs which it had been the purpose to prevent from the beginning. The evolution is clearly pointed out in *National Cotton Oil Co.* v. *Texas*, 197 U.S. 115, and *Shawnee Compress Co.* v. *Anderson*, 209 U.S. 423; and, indeed, will be found to be illustrated in various aspects by the decisions of this court which have been concerned with the enforcement of the act we are now considering.

Without going into detail and but very briefly surveying the whole field, it may be with accuracy said that the dread of enhancement of prices and of other wrongs which it was thought would flow from the undue limitation on competitive conditions caused by contracts or other acts of individuals or corporations, led, as a matter of public policy, to the prohibition or treating as illegal all contracts or acts which were unreasonably restrictive of competitive conditions, either from the nature or character of the contract or act or where the surrounding circumstances were such as to justify the conclusion that they had not been entered into or performed with the legitimate purpose of reasonably forwarding personal interest and developing trade, but on the contrary were of such a character as to give rise to the inference or presumption that they had been entered into or done with the intent to do wrong to the general public and to limit the right of individuals, thus restraining the free flow of commerce and tending to bring about the evils, such as enhancement of prices, which were considered to be against public policy. It is equally true to say that the survey of the legislation in this country on this subject from the beginning will show, depending as it did upon the economic conceptions which obtained at the time when the legislation was adopted or judicial decision was rendered, that contracts or acts were at one time deemed to be of such a character as to justify the inference of wrongful intent which were at another period thought not to be of that character. But this again, as we have seen, simply followed the line of development of the law of England.

Let us consider the language of the first and second sections, guided by the principle that where words are employed in a statute which had at the time a well-known meaning at common law or in the law of this country they are presumed to have been used in that sense unless the context compels to the contrary. *Swearingen* v.

United States, 161 U.S. 446; *United States* v. *Wong Kim Ark*, 169 U.S. 649; *Keck* v. *United States*, 172 U.S. 446; *Kepner* v. *United States*, 195 U.S. 100, 126.

As to the first section, the words to be interpreted are: "Every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce . . . is hereby declared to be illegal." As there is no room for dispute that the statute was intended to formulate a rule for the regulation of interstate and foreign commerce, the question is what was the rule which it adopted?

In view of the common law and the law in this country as to restraint of trade, which we have reviewed, and the illuminating effect which that history must have under the rule to which we have referred, we think it results:

a. That the context manifests that the statute was drawn in the light of the existing practical conception of the law of restraint of trade, because it groups as within that class, not only contracts which were in restraint of trade in the subjective sense, but all contracts or acts which theoretically were attempts to monopolize, yet which in practice had come to be considered as in restraint of trade in a broad sense.

b. That in view of the many new forms of contracts and combinations which were being evolved from existing economic conditions, it was deemed essential by an all-embracing enumeration to make sure that no form of contract or combination by which an undue restraint of interstate or foreign commerce was brought about could save such restraint from condemnation. The statute under this view evidenced the intent not to restrain the right to make and enforce contracts, whether resulting from combination or otherwise, which did not unduly restrain interstate or foreign commerce, but to protect that commerce from being restrained by methods, whether old or new, which would constitute an interference that is an undue restraint.

c. And as the contracts or acts embraced in the provision were not expressly defined, since the enumeration addressed itself simply to classes of acts, those classes being broad enough to embrace every conceivable contract or combination which could be made concerning trade or commerce or the subjects of such commerce, and thus caused any act done by any of the enumerated methods anywhere in the whole field of human activity to be illegal if in restraint of trade, it inevitably follows that the provision necessarily called for the exercise of judgment which required that some standard should be resorted to for the purpose of determining whether the prohibitions contained in the statute had or had not in any given case been violated. Thus not specifying but indubitably contemplating and requiring a standard, it follows that it was intended that the standard of reason which had been applied at the common law and in this

country in dealing with subjects of the character embraced by the statute, was intended to be the measure used for the purpose of determining whether in a given case a particular act had or had not brought about the wrong against which the statute provided.

And a consideration of the text of the second section serves to establish that it was intended to supplement the first and to make sure that by no possible guise could the public policy embodied in the first section be frustrated or evaded. The prohibitions of the second embrace "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, . . ." By reference to the terms of § 8 it is certain that the word person clearly implies a corporation as well as an individual.

The commerce referred to by the words "any part" construed in the light of the manifest purpose of the statute has both a geographical and a distributive significance, that is it includes any portion of the United States and any one of the classes of things forming a part of interstate or foreign commerce.

Undoubtedly, the words "to monopolize" and "monopolize" as used in the section reach every act bringing about the prohibited results. The ambiguity, if any, is involved in determining what is intended by monopolize. But this ambiguity is readily dispelled in the light of the previous history of the law of restraint of trade to which we have referred and the indication which it gives of the practical evolution by which monopoly and the acts which produce the same result as monopoly, that is, an undue restraint of the course of trade, all came to be spoken of as, and to be indeed synonymous with, restraint of trade. In other words, having by the first section forbidden all means of monopolizing trade, that is, unduly restraining it by means of every contract, combination, etc., the second section seeks, if possible, to make the prohibitions of the act all the more complete and perfect by embracing all attempts to reach the end prohibited by the first section, that is, restraints of trade, by any attempt to monopolize, or monopolization thereof, even although the acts by which such results are attempted to be brought about or are brought about be not embraced within the general enumeration of the first section. And, of course, when the second section is thus harmonized with and made as it was intended to be the complement of the first, it becomes obvious that the criteria to be resorted to in any given case for the purpose of ascertaining whether violations of the section have been committed, is the rule of reason guided by the established law and by the plain duty to enforce the prohibitions of the act and thus the public policy which its restrictions were obviously enacted to subserve. And it is worthy of observation, as we

have previously remarked concerning the common law, that although the statute by the comprehensiveness of the enumerations embodied in both the first and second sections makes it certain that its purpose was to prevent undue restraints of every kind or nature, nevertheless by the omission of any direct prohibition against monopoly in the concrete it indicates a consciousness that the freedom of the individual right to contract when not unduly or improperly exercised was the most efficient means for the prevention of monopoly, since the operation of the centrifugal and centripetal forces resulting from the right to freely contract was the means by which monopoly would be inevitably prevented if no extraneous or sovereign power imposed it and no right to make unlawful contracts having a monopolistic tendency were permitted. In other words that freedom to contract was the essence of freedom from undue restraint on the right to contract.

In substance, the propositions urged by the Government are reducible to this: That the language of the statute embraces every contract, combination, etc., in restraint of trade, and hence its text leaves no room for the exercise of judgment, but simply imposes the plain duty of applying its prohibitions to every case within its literal language. The error involved lies in assuming the matter to be decided. This is true because as the acts which may come under the classes stated in the first section and the restraint of trade to which that section applies are not specifically enumerated or defined, it is obvious that judgment must in every case be called into play in order to determine whether a particular act is embraced within the statutory classes, and whether if the act is within such classes its nature or effect causes it to be a restraint of trade within the intendment of the act. To hold to the contrary would require the conclusion either that every contract, act or combination of any kind or nature, whether it operated a restraint on trade or not, was within the statute, and thus the statute would be destructive of all right to contract or agree or combine in any respect whatever as to subjects embraced in interstate trade or commerce, or if this conclusion were not reached, then the contention would require it to be held that as the statute did not define the things to which it related and excluded resort to the only means by which the acts to which it relates could be ascertained — the light of reason — the enforcement of the statute was impossible because of its uncertainty. The merely generic enumeration which the statute makes of the acts to which it refers and the absence of any definition of restraint of trade as used in the statute leaves room for but one conclusion, which is, that it was expressly designed not to unduly limit the application of the act by precise definition, but while clearly fixing a standard, that is, by defining the ulterior boundaries which could not be transgressed with impunity, to leave it to be determined by the light of reason, guided by the principles of

law and the duty to apply and enforce the public policy embodied in the statute, in every given case whether any particular act or contract was within the contemplation of the statute.

But, it is said, persuasive as these views may be, they may not be here applied, because the previous decisions of this court have given to the statute a meaning which expressly excludes the construction which must result from the reasoning stated. The cases are *United States* v. *Freight Association*, 166 U.S. 290, and *United States* v. *Joint Traffic Association*, 171 U.S. 505. Both the cases involved the legality of combinations or associations of railroads engaged in interstate commerce for the purpose of controlling the conduct of the parties to the association or combination in many particulars. The association or combination was assailed in each case as being in violation of the statute. It was held that they were. It is undoubted that in the opinion in each case general language was made use of, which, when separated from its context, would justify the conclusion that it was decided that reason could not be resorted to for the purpose of determining whether the acts complained of were within the statute. It is, however, also true that the nature and character of the contract or agreement in each case was fully referred to and suggestions as to their unreasonableness pointed out in order to indicate that they were within the prohibitions of the statute. As the cases cannot by any possible conception be treated as authoritative without the certitude that reason was resorted to for the purpose of deciding them, it follows as a matter of course that it must have been held by the light of reason, since the conclusion could not have been otherwise reached, that the assailed contracts or agreements were within the general enumeration of the statute, and that their operation and effect brought about the restraint of trade which the statute prohibited. This being inevitable, the deduction can in reason only be this: That in the cases relied upon it having been found that the acts complained of were within the statute and operated to produce the injuries which the statute forbade, that resort to reason was not permissible in order to allow that to be done which the statute prohibited. This being true, the rulings in the cases relied upon when rightly appreciated were therefore this and nothing more: That as considering the contracts or agreements, their necessary effect and the character of the parties by whom they were made, they were clearly restraints of trade within the purview of the statute, they could not be taken out of that category by indulging in general reasoning as to the expediency or non-expediency of having made the contracts or the wisdom or want of wisdom of the statute which prohibited their being made. That is to say, the cases but decided that the nature and character of the contracts, creating as they did a conclusive presumption which brought them within the statute, such result was not to be disregarded by the substitution of a judicial

appreciation of what the law ought to be for the plain judicial duty of enforcing the law as it was made.

But aside from reasoning it is true to say that the cases relied upon do not when rightly construed sustain the doctrine contended for as established by all of the numerous decisions of this court which have applied and enforced the Anti-Trust Act, since they all in the very nature of things rest upon the premise that reason was the guide by which the provisions of the act were in every case interpreted. Indeed intermediate the decision of the two cases, that is, after the decision in the *Freight Association Case* and before the decision in the *Joint Traffic Case*, the case of *Hopkins* v. *United States*, 171 U.S. 578, was decided, the opinion being delivered by Mr. Justice PECKHAM, who wrote the opinions in both the *Freight Association* and the *Joint Traffic Cases*. And, referring in the *Hopkins Case* to the broad claim made as to the rule of interpretation announced in the *Freight Association Case*, it was said (p. 592): "To treat as condemned by the act all agreements under which, as a result, the cost of conducting an interstate commercial business may be increased would enlarge the application of the act far beyond the fair meaning of the language used. There must be some direct and immediate effect upon interstate commerce in order to come within the act." And in the *Joint Traffic Case* this statement was expressly reiterated and approved and illustrated by example; like limitation on the general language used in *Freight Association* and *Joint Traffic Cases* is also the clear result of *Bement* v. *National Harrow Co.*, 186 U.S. 70, 92, and especially of *Cincinnati Packet Co.* v. *Bay*, 200 U.S. 179.

If the criterion by which it is to be determined in all cases whether every contract, combination, etc., is a restraint of trade within the intendment of the law, is the direct or indirect effect of the acts involved, then of course the rule of reason becomes the guide, and the construction which we have given the statute, instead of being refuted by the cases relied upon, is by those cases demonstrated to be correct. This is true, because as the construction which we have deduced from the history of the act and the analysis of its text is simply that in every case where it is claimed that an act or acts are in violation of the statute the rule of reason, in the light of the principles of law and the public policy which the act embodies, must be applied. From this it follows, since that rule and the result of the test as to direct or indirect, in their ultimate aspect, come to one and the same thing, that the difference between the two is therefore only that which obtains between things which do not differ at all.

If it be true that there is this identity of result between the rule intended to be applied in the *Freight Association Case*, that is, the rule of direct and indirect, and the rule of reason which under the statute as we construe it should be here applied, it may be asked how was it that in the opinion in the *Freight Association Case* much con-

sideration was given to the subject of whether the agreement or combination which was involved in that case could be taken out of the prohibitions of the statute upon the theory of its reasonableness. The question is pertinent and must be fully and frankly met, for if it be now deemed that the *Freight Association Case* was mistakenly decided or too broadly stated, the doctrine which it announced should be either expressly overruled or limited.

The confusion which gives rise to the question results from failing to distinguish between the want of power to take a case which by its terms or the circumstances which surrounded it, considering among such circumstances the character of the parties, is plainly within the statute, out of the operation of the statute by resort to reason in effect to establish that the contract ought not to be treated as within the statute, and the duty in every case where it becomes necessary from the nature and character of the parties to decide whether it was within the statute to pass upon that question by the light of reason. This distinction, we think, serves to point out what in its ultimate conception was the thought underlying the reference to the rule of reason made in the *Freight Association Case*, especially when such reference is interpreted by the context of the opinion and in the light of the subsequent opinion in the *Hopkins Case* and in *Cincinnati Packet Company* v. *Bay*, 200 U.S. 179.

And in order not in the slightest degree to be wanting in frankness, we say that in so far, however, as by separating the general language used in the opinions in the *Freight Association* and *Joint Traffic Cases* from the context and the subject and parties with which the cases were concerned, it may be conceived that the language referred to conflicts with the construction which we give the statute, they are necessarily now limited and qualified. We see no possible escape from this conclusion if we are to adhere to the many cases decided in this court in which the Anti-Trust Law has been applied and enforced and if the duty to apply and enforce that law in the future is to continue to exist. The first is true, because the construction which we now give the statute does not in the slightest degree conflict with a single previous case decided concerning the Anti-Trust Law aside from the contention as to the *Freight Association* and *Joint Traffic Cases*, and because every one of those cases applied the rule of reason for the purpose of determining whether the subject before the court was within the statute. The second is also true, since, as we have already pointed out, unaided by the light of reason it is impossible to understand how the statute may in the future be enforced and the public policy which it establishes be made efficacious.

So far as the objections of the defendants are concerned they are all embraced under two headings: —

a. That the act, even if the averments of the bill be true, cannot be constitutionally applied, because to do so would extend the power

of Congress to subjects *dehors* the reach of its authority to regulate commerce, by enabling that body to deal with mere questions of production of commodities within the States. But all the structure upon which this argument proceeds is based upon the decision in *United States* v. *E. C. Knight Co.*, 156 U.S. 1. The view, however, which the argument takes of that case and the arguments based upon that view have been so repeatedly pressed upon this court in connection with the interpretation and enforcement of the Anti-Trust Act, and have been so necessarily and expressly decided to be unsound as to cause the contentions to be plainly foreclosed and to require no express notice. *United States* v. *Northern Securities Co.*, 193 U.S. 197, 334; *Loewe* v. *Lawlor*, 208 U.S. 274; *Swift & Co.* v. *United States*, 196 U.S. 375; *Montague* v. *Lowry*, 193 U.S. 38; *Shawnee Compress Co.* v. *Anderson*, 209 U.S. 423.

b. Many arguments are pressed in various forms of statement which in substance amount to contending that the statute cannot be applied under the facts of this case without impairing rights of property and destroying the freedom of contract or trade, which is essentially necessary to the well-being of society and which it is insisted is protected by the constitutional guaranty of due process of law. But the ultimate foundation of all these arguments is the assumption that reason may not be resorted to in interpreting and applying the statute, and therefore that the statute unreasonably restricts the right to contract and unreasonably operates upon the right to acquire and hold property. As the premise is demonstrated to be unsound by the construction we have given the statute, of course the propositions which rest upon that premise need not be further noticed.

So far as the arguments proceed upon the conception that in view of the generality of the statute it is not susceptible of being enforced by the courts because it cannot be carried out without a judicial exertion of legislative power, they are clearly unsound. The statute certainly generically enumerates the character of acts which it prohibits and the wrong which it was intended to prevent. The propositions therefore but insist that, consistently with the fundamental principles of due process of law, it never can be left to the judiciary to decide whether in a given case particular acts come within a generic statutory provision. But to reduce the propositions, however, to this their final meaning makes it clear that in substance they deny the existence of essential legislative authority and challenge the right of the judiciary to perform duties which that department of the government has exerted from the beginning. This is so clear as to require no elaboration. Yet, let us demonstrate that which needs no demonstration, by a few obvious examples. Take for instance the familiar cases where the judiciary is called upon to determine whether a particular act or acts are within a given prohibition, depending

upon wrongful intent. Take questions of fraud. Consider the power which must be exercised in every case where the courts are called upon to determine whether particular acts are invalid which are, abstractly speaking, in and of themselves valid, but which are asserted to be invalid because of their direct effect upon interstate commerce.

Beyond dispute the proofs establish substantially as alleged in the bill the following facts:

1. The creation of the Standard Oil Company of Ohio;

2. The organization of the Standard Oil Trust of 1882, and also a previous one of 1879, not referred to in the bill, and the proceedings in the Supreme Court of Ohio, culminating in a decree based upon the finding that the company was unlawfully a party to that trust; the transfer by the trustees of stocks in certain of the companies; the contempt proceedings; and, finally, the increase of the capital of the Standard Oil Company of New Jersey and the acquisition by that company of the shares of the stock of the other corporations in exchange for its certificates.

The vast amount of property and the possibilities of far-reaching control which resulted from the facts last stated are shown by the statement which we have previously annexed concerning the parties to the trust agreement of 1882, and the corporations whose stock was held by the trustees under the trust and which came therefore to be held by the New Jersey corporation. But these statements do not with accuracy convey an appreciation of the situation as it existed at the time of the entry of the decree below, since during the more than ten years which elapsed between the acquiring by the New Jersey corporation of the stock and other property which was formerly held by the trustees under the trust agreement, the situation of course had somewhat changed, a change which when analyzed in the light of the proof, we think, establishes that the result of enlarging the capital stock of the New Jersey company and giving it the vast power to which we have referred produced its normal consequence, that is, it gave to the corporation, despite enormous dividends and despite the dropping out of certain corporations enumerated in the decree of the court below, an enlarged and more perfect sway and control over the trade and commerce in petroleum and its products.

Giving to the facts just stated the weight which it was deemed they were entitled to, in the light afforded by the proof of other cognate facts and circumstances, the court below held that the acts and dealings established by the proof operated to destroy the "potentiality of competition" which otherwise would have existed to such an extent as to cause the transfers of stock which were made to the New Jersey corporation and the control which resulted over the many and various subsidiary corporations to be a combination or

conspiracy in restraint of trade in violation of the first section of the act, but also to be an attempt to monopolize and a monopolization bringing about a perennial violation of the second section.

We see no cause to doubt the correctness of these conclusions, considering the subject from every aspect, that is, both in view of the facts established by the record and the necessary operation and effect of the law as we have construed it upon the inferences deducible from the facts, for the following reasons:

a. Because the unification of power and control over petroleum and its products which was the inevitable result of the combining in the New Jersey corporation by the increase of its stock and the transfer to it of the stocks of so many other corporations, aggregating so vast a capital, gives rise, in and of itself, in the absence of countervailing circumstances, to say the least, to the *prima facie* presumption of intent and purpose to maintain the dominancy over the oil industry, not as a result of normal methods of industrial development, but by new means of combination which were resorted to in order that greater power might be added than would otherwise have arisen had normal methods been followed, the whole with the purpose of excluding others from the trade and thus centralizing in the combination a perpetual control of the movements of petroleum and its products in the channels of interstate commerce.

b. Because the *prima facie* presumption of intent to restrain trade, to monopolize and to bring about monopolization resulting from the act of expanding the stock of the New Jersey corporation and vesting it with such vast control of the oil industry, is made conclusive by considering, 1, the conduct of the persons or corporations who were mainly instrumental in bringing about the extension of power in the New Jersey corporation before the consummation of that result and prior to the formation of the trust agreements of 1879 and 1882; 2, by considering the proof as to what was done under those agreements and the acts which immediately preceded the vesting of power in the New Jersey corporation as well as by weighing the modes in which the power vested in that corporation has been exerted and the results which have arisen from it.

Recurring to the acts done by the individuals or corporations who were mainly instrumental in bringing about the expansion of the New Jersey corporation during the period prior to the formation of the trust agreements of 1879 and 1882, including those agreements, not for the purpose of weighing the substantial merit of the numerous charges of wrongdoing made during such period, but solely as an aid for discovering intent and purpose, we think no disinterested mind can survey the period in question without being irresistibly driven to the conclusion that the very genius for commercial development and organization which it would seem was manifested from the beginning soon begot an intent and purpose to exclude others which

was frequently manifested by acts and dealings wholly inconsistent with the theory that they were made with the single conception of advancing the development of business power by usual methods, but which on the contrary necessarily involved the intent to drive others from the field and to exclude them from their right to trade and thus accomplish the mastery which was the end in view. And, considering the period from the date of the trust agreements of 1879 and 1882, up to the time of the expansion of the New Jersey corporation, the gradual extension of the power over the commerce in oil which ensued, the decision of the Supreme Court of Ohio, the tardiness or reluctance in conforming to the commands of that decision, the method first adopted and that which finally culminated in the plan of the New Jersey corporation, all additionally serve to make manifest the continued existence of the intent which we have previously indicated and which among other things impelled the expansion of the New Jersey corporation. The exercise of the power which resulted from that organization fortifies the foregoing conclusions, since the development which came, the acquisition here and there which ensued of every efficient means by which competition could have been asserted, the slow but resistless methods which followed by which means of transportation were absorbed and brought under control, the system of marketing which was adopted by which the country was divided into districts and the trade in each district in oil was turned over to a designated corporation within the combination and all others were excluded, all lead the mind up to a conviction of a purpose and intent which we think is so certain as practically to cause the subject not to be within the domain of reasonable contention.

The inference that no attempt to monopolize could have been intended, and that no monopolization resulted from the acts complained of, since it is established that a very small percentage of the crude oil produced was controlled by the combination, is unwarranted. As substantial power over the crude product was the inevitable result of the absolute control which existed over the refined product, the monopolization of the one carried with it the power to control the other, and if the inferences which this situation suggests were developed, which we deem it unnecessary to do, they might well serve to add additional cogency to the presumption of intent to monopolize which we have found arises from the unquestioned proof on other subjects.

Mr. Justice HARLAN concurred with the majority in its conclusion that relief should be given to the United States, but dissented from the reasoning of Mr. Chief Justice WHITE. Extracts from his opinion follow.

[After quoting from the opinion of the court in the *Trans-Missouri Freight Case,* 166 U.S. 290.]

It thus appears that fifteen years ago, when the purpose of Congress in passing the Anti-Trust Act was fresh in the minds of courts, lawyers, statesmen and the general public, this court expressly declined to indulge in judicial legislation, by inserting in the act the word "unreasonable" or any other word of like import. It may be stated here that the country at large accepted this view of the act, and the Federal courts throughout the entire country enforced its provisions according to the interpretation given in the *Freight Association Case.* What, then, was to be done by those who questioned the soundness of the interpretation placed on the act by this court in that case? As the court had decided that to insert the word "unreasonable" in the act would be "judicial legislation" on its part, the only alternative left to those who opposed the decision in that case was to induce Congress to so *amend* the act as to recognize the right to restrain interstate commerce to a *reasonable* extent. The public press, magazines and law journals, the debates in Congress, speeches and addresses by public men and jurists, all contain abundant evidence of the general understanding that the meaning, extent and scope of the Anti-Trust Act had been judicially determined by this court, and that the only question remaining open for discussion was the wisdom of the policy declared by the act — a matter that was exclusively within the cognizance of Congress. But at every session of Congress since the decision of 1896, the lawmaking branch of the Government, with full knowledge of that decision, has refused to change the policy it had declared or to so amend the act of 1890 as to except from its operation contracts, combinations and trusts that *reasonably* restrain interstate commerce.

But those who were in combinations that were illegal did not despair. They at once set up the baseless claim that the decision of 1896 disturbed the "business interests of the country," and let it be known that they would never be content until the rule was established that would permit interstate commerce to be subjected to *reasonable* restraints. Finally, an opportunity came again to raise the same question which this court had, upon full consideration, determined in 1896. I now allude to the case of *United States* v. *Joint Traffic Association*, 171 U.S. 505, decided in 1898. What was that case?

It was a suit by the United States against more than thirty railroad companies to have the court declare illegal, under the Anti-Trust Act, a certain agreement between these companies. The relief asked was denied in the subordinate Federal courts and the Government brought the case here.

It is important to state the points urged in that case by the defendant companies charged with violating the Anti-Trust Act, and to show that the court promptly met them. To that end I make a copious extract from the opinion in the *Joint Traffic Case.* Among other things, the court said: "Upon comparing that agreement [the

one in the *Joint Traffic Case*, then under consideration, 171 U.S. 505] with the one set forth in the case of *United States* v. *Trans-Missouri Freight Association*, 166 U.S. 290, the great similarity between them suggests that a similar result should be reached in the two cases" (p. 558). Learned counsel in the *Joint Traffic Case* urged a reconsideration of the question decided in the *Trans-Missouri Case* contending that "the decision in that case [the *Trans-Missouri Freight Case*] is quite plainly erroneous, and the consequences of such error are far reaching and disastrous, and clearly at war with justice and sound policy, and the construction placed upon the Anti-Trust statute has been received by the public with surprise and alarm." They suggested that the point made in the *Joint Traffic Case* as to the meaning and scope of the act might have been but was not made in the previous case. The court said (171 U.S. 559) that "the report of the *Trans-Missouri Case* clearly shows not only that the point now taken *was* there urged upon the attention of the court, but it was then *intentionally* and *necessarily* decided."

The question whether the court should again consider the point decided in the *Trans-Missouri Case*, 171 U.S. 573, was disposed of in the most decisive language, as follows: "Finally, we are asked to reconsider the question decided in the *Trans-Missouri Case*, and to retrace the steps taken therein, because of the plain error contained in that decision and the widespread alarm with which it was received and the serious consequences which have resulted, or may soon result, from the law as interpreted in that case. It is proper to remark that an application for a reconsideration of a question but lately decided by this court is usually based upon a statement that some of the arguments employed on the original hearing of the question have been overlooked or misunderstood, or that some controlling authority has been either misapplied by the court or passed over without discussion or notice. While this is not strictly an application for a rehearing in the same case, yet in substance it is the same thing. The court is asked to reconsider a question but just decided after a careful investigation of the matter involved. There have heretofore been in effect two arguments of precisely the same questions now before the court, and the same arguments were addressed to us on both those occasions. The report of the *Trans-Missouri Case* shows a dissenting opinion delivered in that case, and that the opinion was concurred in by three other members of the court. That opinion, it will be seen, gives with great force and ability the arguments against the decision which was finally arrived at by the court. It was after a full discussion of the questions involved and with the knowledge of the views entertained by the minority as expressed in the dissenting opinion, that the majority of the court came to the conclusion it did. Soon after the decision a petition for a rehearing of the case was made, supported by a printed argument in its favor, and pressed

with an earnestness and vigor and at a length which were certainly commensurate with the importance of the case. This court, *with care and deliberation* and also with a full appreciation of their importance, again considered the questions involved in its former decision. A majority of the court once more arrived at the conclusion it had first announced, and accordingly it denied the application. And now *for the third time* the same arguments are employed, and the court is again asked to recant its former opinion, and to decide the same question in direct opposition to the conclusion arrived at in the *Trans-Missouri Case.* The learned counsel while making the application frankly confess that the argument in opposition to the decision in the case above named has been so fully, so clearly and so forcibly presented in the dissenting opinion of Mr. Justice WHITE [in the *Freight Case*] that it is hardly possible to add to it, nor is it necessary to repeat it. The fact that there was so close a division of opinion in this court when the matter was first under advisement, together with the different views taken by some of the judges of the lower courts, led us to the most careful and scrutinizing examination of the arguments advanced by both sides, and it was after such an examination that the majority of the court came to the conclusion it did. It is not now alleged that the court on the former occasion overlooked any argument for the respondents or misapplied any controlling authority. It is simply insisted that the court, notwithstanding the arguments for an opposite view, arrived at an erroneous result, which, for reasons already stated, ought to be reconsidered and reversed. *As we have twice already deliberately and earnestly considered the same arguments which are now for a third time pressed upon our attention,* it could hardly be expected that our opinion should now change from that already expressed."

These utterances, taken in connection with what was previously said in the *Trans-Missouri Freight Case,* show so clearly and affirmatively as to admit of no doubt that this court, many years ago, upon the fullest consideration, interpreted the Anti-Trust Act as prohibiting and making illegal not only *every* contract or combination, in whatever form, which was in restraint of interstate commerce, without regard to its reasonableness or unreasonableness, but all monopolies or attempts to monopolize "any part" of such trade or commerce.

In this connection it may be well to refer to the adverse report made in 1909, by Senator Nelson, on behalf of the Senate Judiciary Committee, in reference to a certain bill offered in the Senate and which proposed to amend the Anti-Trust Act in various particulars. That report contains a full, careful and able analysis of judicial decisions relating to combinations and monopolies in restraint of trade and commerce. Among other things said in it which bear on the questions involved in the present case are these: "The Anti-

Trust Act makes it a criminal offense to violate the law, and provides a punishment both by fine and imprisonment. To inject into the act the question of whether an agreement or combination is *reasonable* or *unreasonable* would render the act as a criminal or penal statute indefinite and uncertain, and hence, to that extent, utterly nugatory and void, and would practically amount to a repeal of that part of the act. . . . And while the same technical objection does not apply to civil prosecutions, *the injection of the rule of reasonableness or unreasonableness would lead to the greatest variableness and uncertainty in the enforcement of the law. The defense of reasonable restraint would be made in every case and there would be as many different rules of reasonableness as cases, courts, and juries.* What one court or jury might deem unreasonable another court or jury might deem reasonable. A court or jury in Ohio might find a given agreement or combination reasonable, while a court and jury in Wisconsin might find the same agreement and combination unreasonable. In the case of *People* v. *Sheldon*, 139 N.Y. 264, Chief Justice ANDREWS remarks: 'If agreements and combinations to prevent competition in prices are or may be hurtful to trade, *the only sure remedy is to prohibit all agreements of that character.* If the validity of such an agreement was made to depend upon actual proof of public prejudice or injury, it would be very difficult in any case to establish the invalidity, although the moral evidence might be very convincing.' . . . To amend the Anti-Trust Act, as suggested by this bill, would be to entirely emasculate it, and for all practical purposes render it nugatory as a remedial statute. Criminal prosecutions would not lie and civil remedies would labor under the greatest doubt and uncertainty. The act as it exists is clear, comprehensive, certain and highly remedial. It practically covers the field of Federal jurisdiction, and is in every respect a model law. To destroy or undermine it at the present juncture, when combinations are on the increase, and appear to be as oblivious as ever of the rights of the public, would be a calamity." The result was the indefinite postponement by the Senate of any further consideration of the proposed amendments of the Anti-Trust Act.

After what has been adjudged, upon full consideration, as to the meaning and scope of the Anti-Trust Act, and in view of the usages of this court when attorneys for litigants have attempted to reopen questions that have been deliberately decided, I confess to no little surprise as to what has occurred in the present case. The court says that the previous cases, above cited, "cannot by any possible conception be treated as authoritative without the certitude that *reason* was resorted to for the purpose of deciding them." And its opinion is full of intimations that this court proceeded in those cases, so far as the present question is concerned, without being guided by the "rule of reason," or "the light of reason." It is more than once

intimated, if not suggested, that if the Anti-Trust Act is to be construed as prohibiting *every* contract or combination, of whatever nature, which is in fact in restraint of commerce, regardless of the reasonableness or unreasonableness of such restraint, that fact would show that the court had not proceeded, in its decision, according to "the light of reason," but had disregarded the "rule of reason." If the court, in those cases, was wrong in its construction of the act, it is certain that it fully apprehended the views advanced by learned counsel in previous cases and pronounced them to be untenable. The published reports place this beyond all question. The opinion of the court was delivered by a Justice of wide experience as a judicial officer, and the court had before it the Attorney General of the United States and lawyers who were recognized, on all sides, as great leaders in their profession. The same eminent jurist who delivered the opinion in the *Trans-Missouri Case* delivered the opinion in the *Joint Traffic Association Case*, and the Association in that case was represented by lawyers whose ability was universally recognized. Is it to be supposed that any point escaped notice in those cases when we think of the sagacity of the Justice who expressed the views of the court, or of the ability of the profound, astute lawyers, who sought such an interpretation of the act as would compel the court to insert words in the statute which Congress had not put there, and the insertion of which words, would amount to "judicial legislation"? Now this court is asked to do that which it has distinctly declared it could not and would not do, and has now done what it then said it could not constitutionally do. It has, by mere interpretation, modified the act of Congress, and deprived it of practical value as a defensive measure against the evils to be remedied. On reading the opinion just delivered, the first inquiry will be, that as the court is unanimous in holding that the particular things done by the Standard Oil Company and its subsidiary companies, in this case, were illegal under the Anti-Trust Act, whether those things were in reasonable or unreasonable restraint of interstate commerce, why was it necessary to make an elaborate argument, as is done in the opinion, to show that according to the "rule of reason" the act as passed by Congress should be interpreted as if it contained the word "unreasonable" or the word "undue"? The only answer which, in frankness, can be given to this question is, that the court intends to decide that its deliberate judgment, fifteen years ago, to the effect that the act permitted no restraint whatever of interstate commerce, whether reasonable or unreasonable, was not in accordance with the "rule of reason." In effect the court says, that it will now, for the first time, bring the discussion under the "light of reason" and apply the "rule of reason" to the questions to be decided. I have the authority of this court for saying that such a course of proceeding on its part would be "judicial legislation."

UNITED STATES *v.* AMERICAN TOBACCO CO.

221 U.S. 106. 1911.

MR. CHIEF JUSTICE WHITE. We shall divide our investigation of the case into three subjects: First, the undisputed facts; second, the meaning of the Anti-Trust Act and its application as correctly construed to the ultimate conclusions of fact deducible from the proof; third, the remedies to be applied.

First. Undisputed facts.

The matters to be considered under this heading we think can best be made clear by stating the merest outline of the condition of the tobacco industry prior to what is asserted to have been the initial movement in the combination which the suit assails and in the light so afforded to briefly recite the history of the assailed acts and contracts. We shall divide the subject into two periods, (*a*) the one from the time of the organization of the first or old American Tobacco Company in 1890 to the organization of the Continental Tobacco Company, and (*b*) from the date of such organization to the filing of the bill in this case.

Summarizing in the broadest way the conditions which obtained prior to 1890, as to the production, manufacture and distribution of tobacco, the following general facts are adequate to portray the situation.

Tobacco was grown in many sections of the country having diversity of soil and climate and therefore was subject to various vicissitudes resulting from the places of production and consequently varied in quality. The great diversity of use to which tobacco was applied in manufacturing caused it to be that there was a demand for all the various qualities. The demand for all qualities was not local, but widespread, extending as well to domestic as to foreign trade, and, therefore, all the products were marketed under competitive conditions of a peculiarly advantageous nature. The manufacture of the product in this country in various forms was successfully carried on by many individuals or concerns scattered throughout the country, a larger number perhaps of the manufacturers being in the vicinage of production and others being advantageously situated in or near the principal markets of distribution.

Before January, 1890, five distinct concerns — Allen & Ginter, with factory at Richmond, Va.; W. Duke, Sons & Co., with factories at Durham, North Carolina, and New York City; Kinney Tobacco Company, with factory at New York City; W. S. Kimball & Company, with factory at Rochester, New York; Goodwin & Company, with factory at Brooklyn, New York — manufactured, distributed and sold in the United States and abroad 95 per cent of all the domestic cigarette and less than 8 per cent of the smoking tobacco

produced in the United States. There is no doubt that these factories were competitors in the purchase of the raw product which they manufactured and in the distribution and sale of the manufactured products. Indeed it is shown that prior to 1890 not only had normal and ordinary competition existed between the factories in question, but that the competition had been fierce and abnormal. In January, 1890, having agreed upon a capital stock of $25,000,000, all to be divided amongst them, and who should be directors, the concerns referred to organized the American Tobacco Company in New Jersey, "for trading and manufacturing," with broad powers, and conveyed to it the assets and businesses, including good will and right to use the names of the old concerns; and thereafter this corporation carried on the business of all. The $25,000,000 of stock of the Tobacco Company was allotted to the charter members as follows: Allen & Ginter, $3,000,000 preferred, $4,500,000 common; W. Duke, Sons & Co., $3,000,000 preferred, $4,500,000 common; Kinney Tobacco Company, $2,000,000 preferred, $3,000,000 common; W. S. Kimball & Co., $1,000,000 preferred, $1,500,000 common; and Goodwin & Co., $1,000,000 preferred, $1,500,000 common.

There is a charge that the valuation at which the respective properties were capitalized in the new corporation was enormously in excess of their actual value. We, however, put that subject aside, since we propose only to deal with facts which are not in controversy.

Shortly after the formation of the new corporation the Goodwin & Co. factory was closed, and the directors ordered "that the manufacture of all tobacco cigarettes be concentrated at Richmond." The new corporation in 1890, the first year of its operation, manufactured about two and one half billion cigarettes, that is, about 96 or 97 per cent of the total domestic output, and about five and one half million pounds of smoking tobacco out of a total domestic product of nearly seventy million pounds.

In a little over a year after the organization of the company it increased its capital stock by ten million dollars. The purpose of this increase is inferable from the considerations which we now state.

There was a firm known as Pfingst, Doerhoefer & Co., consisting of a number of partners, who had been long and successfully carrying on the business of manufacturing plug tobacco in Louisville, Kentucky, and distributing it through the channels of interstate commerce. In January, 1891, this firm was converted into a corporation known as the National Tobacco Works, having a capital stock of $400,000 all of which was issued to the partners. Almost immediately thereafter, in the month of February, the American Tobacco Company became the purchaser of all the capital stock of the new corporation, paying $600,000 cash and $1,200,000 in stock of the American Tobacco Company. The members of the previously existing firm bound themselves by contract with the American

Tobacco Company to enter its service and manage the business and property sold, and each further agreed that for ten years he would not engage in carrying on, directly or indirectly, or permit or suffer the use of his name in connection with the carrying on of the tobacco business in any form.

In April following, the American Tobacco Company bought out the business of Philip Whitlock, of Richmond, Virginia, who was engaged in the manufacture of cheroots and cigars, and with the exclusive right to use the name of Whitlock. The consideration for this purchase was $300,000, and Whitlock agreed to become an employé of the American Tobacco Company for a number of years and not to engage for twenty years in the tobacco business.

In the month of April the American Tobacco Company also acquired the business of Marburg Brothers, a well-known firm located at Baltimore, Maryland, and engaged in the manufacture and distribution of tobacco, principally smoking and snuff. The consideration was a cash payment of $164,637.65 and stock to the amount of $3,075,000. The members of the firm also conveyed the right to the use of the firm name and agreed not to engage in the tobacco business for a lengthy period.

Again, in the same month, the American Tobacco Company bought out a tobacco firm of old standing, also located in Baltimore, known as G. W. Gail & Ax, engaged principally in manufacturing and selling smoking tobacco, buying with the business the exclusive right to use the name of the firm or the partners, and the members of the firm agreed not to engage in the tobacco business for a specified period. The consideration for this purchase was $77,582.66 in cash and stock to the amount of $1,760,000. The plant was abandoned soon after.

Referring to the occurrences of the year 1891, as in all respects typical of the occurrences which took place in all the other years of the first period, that is during the years 1892, 1893, 1894, 1895, 1896, 1897 and 1898 we content ourselves with saying that it is undisputed that between February, 1891, and October, 1898, including the purchases which we have specifically referred to, the American Tobacco Company acquired fifteen going tobacco concerns doing business in the States of Kentucky, Louisiana, Maryland, Michigan, Missouri, New York, North Carolina and Virginia. For ten of the plants an all cash consideration of $6,410,235.26 was paid, while the payments for the remaining five aggregated in cash $1,115,100.95 and in stock $4,123,000. It is worth nothing that the last purchase, in October, 1898, was of the Drummond Tobacco Company, a Missouri corporation dealing principally in plug, for which a cash consideration was paid of $3,457,500.

The corporations which were combined for the purpose of forming the American Tobacco Company produced a very small portion of

plug tobacco. That an increase in this direction was contemplated is manifested by the almost immediate increase of the stock and its use for the purpose of acquiring, as we have indicated, in 1891 and 1892, the ownership and control of concerns manufacturing plug tobacco and the consequent increase in that branch of production. There is no dispute that as early as 1893 the president of the American Tobacco Company, by authority of the corporation, approached leading manufacturers of plug tobacco and sought to bring about a combination of the plug tobacco interests, and upon the failure to accomplish this, ruinous competition, by lowering the price of plug below its cost, ensued. As a result of this warfare, which continued until 1898, the American Tobacco Company sustained severe losses aggregating more than four millions of dollars. The warfare produced its natural result, not only because the company acquired during the last two years of the campaign, as we have stated, control of important plug tobacco concerns, but others engaged in that industry came to terms. We say this because in 1898, in connection with several leading plug manufacturers, the American Tobacco Company organized a New Jersey corporation styled the Continental Tobacco Company, for "trading and manufacturing," with a capital of $75,000,000, afterwards increased to $100,000,000. The new company issued its stock and took transfers to the plants, assets and businesses of five large and successful competing plug manufacturers.

The American Tobacco Company also conveyed to this corporation, at large valuations, the assets, brands, real estate and good will pertaining to its plug tobacco business, including the National Tobacco Works, the James G. Butler Tobacco Co., Drummond Tobacco Company, and Brown Tobacco Co., receiving as consideration $30,274,200 of stock (one-half common and one-half preferred), $300,000 cash, and an additional sum for losses sustained in the plug business during 1898, $840,035. Mr. Duke, the president of the American Tobacco Company, also became president of the Continental Company.

Under the preliminary agreement which was made looking to the formation of the Continental Tobacco Company, that company acquired from the holders all the $3,000,000 of the common stock of the P. Lorillard Company in exchange for $6,000,000 of its stock, and $1,581,300 of the $2,000,000 preferred in exchange for notes aggregating a sum considerably larger. The Lorillard Company, however, although it thus passed practically under the control of the American Tobacco Company by virtue of its ownership of stock in the Continental Company, was not liquidated, but its business continued to be conducted as a distinct corporation, its goods being marked and put upon the market just as if they were the manufacture of an independent concern.

Following the organization of the Continental Tobacco Company

the American Tobacco Company increased its capital stock from thirty-five millions of dollars to seventy millions of dollars, and declared a stock dividend of one hundred per cent on its common stock, that is, a stock dividend of $21,000,000.

As the facts just stated bring us to the end of the first period which at the outset we stated it was our purpose to review, it is well briefly to point out the increase in the power and control of the American Tobacco Company and the extension of its activities to all forms of tobacco products which had been accomplished just prior to the organization of the Continental Tobacco Company. Nothing could show it more clearly than the following: At the end of the time the company was manufacturing eighty-six per cent or thereabouts of all the cigarettes produced in the United States, above twenty-six per cent of all the smoking tobacco, more than twenty-two per cent of all plug tobacco, fifty-one per cent of all little cigars, six per cent each of all snuff and fine cut tobacco, and over two per cent of all cigars and cheroots.

A brief reference to the occurrences of the second period, that is, from and after the organization of the Continental Tobacco Company up to the time of the bringing of this suit, will serve to make evident that the transactions in their essence had all the characteristics of the occurrences of the first period.

In the year 1899 and thereafter either the American or the Continental company, for cash or stock, at an aggregate cost of fifty millions of dollars ($50,000,000), bought and closed up some thirty competing corporations and partnerships theretofore engaged in interstate and foreign commerce as manufacturers, sellers, and distributors of tobacco and related commodities, the interested parties covenanting not to engage in the business. Likewise the two corporations acquired for cash, by issuing stock, and otherwise, control of many competing corporations, now going concerns, with plants in various States, Cuba and Porto Rico, which manufactured, bought, sold and distributed tobacco products or related articles throughout the United States and foreign countries, and took from the parties in interest covenants not to engage in the tobacco business.

The plants thus acquired were operated until the merger in 1904, to which we shall hereafter refer, as a part of the general system of the American and Continental companies. The power resulting from and the purpose contemplated in making these acquisitions by the companies just referred to, however, may not be measured by considering alone the business of the company directly acquired, since some of those companies were made the vehicles as representing the American or Continental company for acquiring and holding the stock of other and competing companies, thus amplifying the power resulting from the acquisitions directly made by the American or

Continental company, without ostensibly doing so. It is besides undisputed that in many instances the acquired corporations with the subsidiary companies over which they had control through stock ownership were carried on ostensibly as independent concerns disconnected from either the American or the Continental company, although they were controlled and owned by one or the other of these companies.

It is of the utmost importance to observe that the acquisitions made by the subsidiary corporations in some cases likewise show the remarkable fact stated above, that is, the disbursement of enormous amounts of money to acquire plants, which on being purchased were not utilized but were immediately closed. It is also to be remarked, that the facts stated in the memorandum in the margin show on their face a singular identity between the conceptions which governed the transactions of this latter period with those which evidently existed at the very birth of the original organization of the American Tobacco Company, as exemplified by the transactions in the first period. A statement of particular transactions outside of those previously referred to as having occurred during the period in question will serve additionally to make the situation clear. And to accomplish this purpose we shall, as briefly as may be consistent with clarity, separately refer to the facts concerning the organization during the second period of the five corporations which were named as defendants in the bill, as heretofore stated and which for the purpose of designation we have hitherto classified as accessory defendants, such corporations being the American Snuff Company, American Cigar Company, American Stogie Company, MacAndrews & Forbes Company (licorice), and Conley Foil Company.

1. *The American Snuff Company.*

As we have seen, the American Tobacco Campany at the commencement of the first period produced a very small quantity of snuff. Its capacity, however, in that regard was augmented owing particularly to the formation of the Continental Tobacco Company and the acquisition of the Lorillard Company, by which it came to be a serious factor as a snuff producer. There shortly ensued an aggressive competition in the snuff business between the American Tobacco Company, with the force acquired from the vantage ground resulting from the dominancy of its expanded organization, and others in the trade operating independently of that organization. The result was identical with that which had previously arisen from like conditions in the past.

In March, 1900, there was organized in New Jersey a corporation known as the American Snuff Company, with a capital of $25,000,000, one-half preferred and one-half common, which took over the snuff business of the P. Lorillard Company, Continental Tobacco Company and the American Tobacco Company, with that of a

large competitor, viz: the Atlantic Snuff Co. The stock of the new company was thus apportioned: Atlantic Snuff Company, preferred, \$7,500,000, common, \$25,000,000; P. Lorillard Company, preferred, \$1,124,700, common, \$3,459,400; the American Tobacco Company, preferred, \$1,177,800, common, \$3,227,500; Continental Tobacco Company, preferred, \$197,500, common, \$813,100. The stock issued to Continental Tobacco Company and the defendants, P. Lorillard Company and the American Tobacco Company, is still held by the latter, and they have at all times had a controlling interest in the Snuff Company. All the companies, together with their officers and directors, covenanted that they would not thereafter engage as competitors in the tobacco business or the manufacture, sale, or distribution of snuff.

Among the assets transferred by the Atlantic Snuff Company to American Snuff Company were all the shares (\$600,000) of W. E. Garrett & Sons, Inc., then and now one of the oldest and very largest producers of snuff, for a long time and still engaged at Yorkland, Del., in interstate and foreign commerce in tobacco and its products, and which controlled through stock ownership the Southern Snuff Company, Memphis, Tenn.; Dental Snuff Company, Lynchburg, Va., and Stewart-Ralph Snuff Company, Clarksville, Tenn. The separate existence of W. E. Garrett & Sons, Inc., has been preserved and its business conducted under the corporate name. In March, 1900, the American Snuff Company acquired all the shares of George W. Helme Company, one of the oldest and largest producers of snuff and actively engaged at Helmetta, N.J., in interstate and foreign commerce in competition with defendants, by issuing in exchange therefor \$2,000,000 preferred stock and \$1,000,000 common; and it thereafter took a conveyance of all assets of the acquired company and now operates the plant under its own name.

As a result of the transactions just stated it came to pass that the American Tobacco Company, which had at the end of the first period only a very small percentage of the snuff manufacturing business, came virtually to have the dominant control as a manufacturer of that product.

2. *Conley Foil Company — manufacturers of tinfoil, an essential for packing tobacco products.*

In December, 1899, the American Tobacco Company secured control of the business of John Conley & Sons, a partnership of New York City. By agreement the Conley Foil Company was incorporated in New York "for trading and manufacturing," etc., with \$250,000 capital, ultimately increased to \$825,000. The corporation took over the business and assets of the firm, and the American Tobacco Company became owner of a majority of the shares of stock. The Conley Foil Company has acquired all the shares of stock of the Johnson Tinfoil & Metal Company, of St. Louis, a leading com-

petitor, and they supply under fixed contracts at remunerative prices the tinfoil used by the defendants, which constitutes the major part of the total production in the United States.

3. *American Cigar Company.*

Prior to 1901 the American and Continental Tobacco companies manufactured, sold, and distributed cigars, stogies, and cheroots. In the year stated the companies determined to engage in the business upon a larger scale. Under agreement with Powell, Smith & Company, large manufacturers and dealers in cigars, they caused the incorporation in New Jersey of the American Cigar Company "for trading and manufacturing," etc., to which all three conveyed their said business, and it has since carried on the same. The American and Continental companies each acquired 46½ per cent of the shares, and Powell, Smith & Company 7 per cent; the original capitalization was $10,000,000 (afterwards $20,000,000), and more than three-fourths is owned by the former. The Cigar Company acquired many competitors (partnerships and corporations) engaged in interstate and foreign commerce, taking from the parties covenants against engaging in the tobacco business; and it has also procured the organization of controlled corporations which have acquired competing manufacturers, jobbers and distributors in the United States, Cuba and Porto Rico. It manufactures, sells and distributes a considerable percentage of domestic cigars; is the dominating factor in the tobacco business, foreign and domestic, in Cuba and Porto Rico, and is there engaged in tobacco planting. It also controls corporate jobbers in California, Alabama, Virginia, Pennsylvania, Georgia, Louisiana, New Jersey and Tennessee.

4. *The MacAndrews & Forbes Company — manufacturers of licorice.*

There is no question that licorice paste is an essential ingredient in the manufacture of plug tobacco, and that one who is debarred from obtaining such paste would therefore be unable to engage in or carry on the manufacture of such product. The control over this article was thus secured: In May, 1902, the Continental Company secured control of MacAndrews & Forbes Co. of Newark, New Jersey, and organized "for trading and manufacturing" a corporation known as the MacAndrews & Forbes Co., with a capital of $7,000,000, $4,000,000 preferred and $3,000,000 common, which took over the business of MacAndrew & Forbes and another large competitor. The Continental Company acquired two-thirds of the common stock by agreeing to purchase its supply of paste from the new company. The American Tobacco Company, at the time of the filing the bill, was the owner of $2,112,900 of the common stock and $750,000 preferred. By various purchases and agreements the MacAndrews & Forbes Company acquired, substantially, the business of all competitors. Thus, in June, 1902, it purchased the business of

the Stamford Mfg. Co., of Stamford, Connecticut, and incorporated the National Licorice Company, which acquired the business of Young & Smylie and F. B. & V. P. Scudder, and the National Company agreed with MacAndrews & Forbes not to produce licorice for tobacco manufacturers. In 1906 all the stock in the J. S. Young Company ($1,800,000), which had been organized to take over the business of the J. S. Young Co., of Baltimore, Md., was acquired by the MacAndrews & Forbes Co. The MacAndrews & Forbes Co. use in excess of ninety-five per cent of the licorice root consumed in the United States.

5. *American Stogie Company.*

In May, 1903, the American Cigar Company and the American and Continental Tobacco Companies caused the American Stogie Company to be incorporated in New Jersey, with $11,979,000 capital, which immediately took over the stogie and tobie business of the companies named in exchange for $8,206,275 stock and then in the usual ways acquired the business of others in the manufacture, sale, and distribution of such products, with covenants not to compete. It acquired in exchange for $3,647,725 stock all shares of United States Cigar Company (which had previously acquired and owned the business of important competitors) and subsequently took the conveyance of the plant and assets. The majority shares always have been held by defendant, the American Cigar Company.

As we think the legitimate inferences deducible from the undisputed facts which we have thus stated will be sufficient to dispose of the controversy, we do not deem it necessary to expand this statement so as to cause it to embrace a recital of the undisputed facts concerning the entry of the American Tobacco Company into the retail tobacco trade through the acquisition of a controlling interest in the stock of what is known as the United Cigar Stores Company, as well as to some other subjects which for the sake of brevity we likewise pass over, in order to come at once to a statement concerning the foreign companies.

The English Companies.

In September, 1901, the American Tobacco Co. purchased for $5,347,000 a Liverpool (Eng.) corporation, known as Ogden's Limited, there engaged in manufacturing and distributing tobacco products. A trade conflict which at once ensued caused many of the English manufacturers to combine into an incorporation known as the Imperial Tobacco Company of Great Britain and Ireland, capital 15,000,000, afterwards increased to 18,000,000, pounds sterling. The trade war was continued between this corporation and the American Tobacco Company, with a result substantially identical with that which had hitherto, as we have seen, arisen from such a situation.

In September, 1902, the Imperial and the American companies

entered into contracts (executed in England) stipulating that the former should limit its business to the United Kingdom, except purchasing leaf in the United States (it buys 54,000,000 pounds annually); that the American companies should limit their business to the United States, its dependencies and Cuba; and that the British-American Tobacco Company, with capital of 6,000,000 pounds sterling apportioned between them, should be organized, take over the export business of both, and operate in other countries, etc. This arrangement was immediately put into effect, and has been observed.

The Imperial Company holds one-third and the American Company two-thirds of the capital stock of the British-American Tobacco Company, Limited. The latter company maintains a branch office in New York City and the vice-president of the American Tobacco Company is a principal officer. This company uses large quantities of domestic leaf, partly exported to various plants abroad and about half manufactured here and then exported. By agreement, all this is purchased through the American Tobacco Company. In addition to many plants abroad it has warehouses in various States and plants at Petersburg, Va., and Durham, N.C., where tobacco is manufactured and then exported.

The purchase of necessary leaf tobacco in the United States by the Imperial Company is now made through a resident general agent and is exported as a part of foreign commerce.

Not to break the continuity of the narrative of facts we have omitted in the proper chronological order to state the facts relative to what was known as the Consolidated Tobacco Company. We now particularly refer to that subject.

The Consolidated Tobacco Co.

In June, 1901, parties largely interested in the American and Continental companies caused the incorporation in New Jersey of the Consolidated Tobacco Company, capital $30,000,000 (afterwards $40,000,000), with broad powers and perpetual existence; to do business throughout the world, and to guarantee securities of other companies, etc. A majority of shares was taken by a few individuals connected with the old concerns: A. N. Brady, J. B. Duke, A. H. Payne, Thomas Ryan, W. C. Whitney, and P. A. B. Widener. J. B. Duke, president of both the old companies, became president of the Consolidated. Largely in exchange for bonds the new company acquired substantially all the shares of common stock of the old ones. Its business, of holding and financing, was continued until 1904, when, with the American and Continental companies, it was merged into the present American Tobacco Company.

By proceedings in New Jersey, October, 1904, the (old) American Tobacco Company, Continental Tobacco Company and Consolidated Tobacco Company were merged into one corporation, under

the name of The American Tobacco Company, the principal defendant here. The merged company, with perpetual existence, was capitalized at $180,000,000 ($80,000,000 preferred, ordinarily without power to vote).

Prior to the merger the Consolidated Tobacco Company, a majority of whose $40,000,000 share capital was held by J. B. Duke, Thomas F. Ryan, William C. Whitney, Anthony N. Brady, Peter A. B. Widener and Oliver H. Payne, had acquired, as already stated, nearly all common shares of both old American and Continental companies, and thereby control. The preferred shares, however, were held by many individuals. Through the method of distribution of the stock of the new company, in exchange for shares in the old American and in the Continental Company, it resulted that the same six men in control of the combination through the Consolidated Tobacco Company continued that control by ownership of stock in the merged or new American Tobacco Company. The assets, property, etc., of the old companies passed to the American Tobacco Company (merged), which has since carried on the business.

The record indisputably discloses that after this merger the same methods which were used from the beginning continued to be employed. Thus, it is beyond dispute: First, that since the organization of the new American Tobacco Company that company has acquired four large tobacco concerns, that restrictive covenants against engaging in the tobacco business were taken from the sellers, and that the plants were not continued in operation but were at once abandoned. Second, that the new company has besides acquired control of eight additional concerns, the business of such concerns being now carried on by four separate corporations, all absolutely controlled by the American Tobacco Company, although the connection as to two of these companies with that corporation was long and persistently denied.

Thus reaching the end of the second period and coming to the time of the bringing of the suit, brevity prevents us from stopping to portray the difference between the condition in 1890 when the (old) American Tobacco Company was organized by the consolidation of five competing cigarette concerns and that which existed at the commencement of the suit. That situation and the vast power which the principal and accessory corporate defendants and the small number of individuals who own a majority of the common stock of the new American Tobacco Company exert over the marketing of tobacco as a raw product, its manufacture, its marketing when manufactured, and its consequent movement in the channels of interstate commerce, indeed relatively over foreign commerce, and the commerce of the whole world, in the raw and manufactured products stand out in such bold relief from the undisputed facts which have been stated as to lead us to pass at once to the second funda-

mental proposition which we are required to consider. That is, the construction of the Anti-Trust Act and the application of the act as rightly construed to the situation as proven in consequence of having determined the ultimate and final inferences properly deducible from the undisputed facts which we have stated.

The construction and application of the Anti-Trust Act.

If the Anti-Trust Act is applicable to the entire situation here presented and is adequate to afford complete relief for the evils which the United States insist that situation presents it can only be because that law will be given a more comprehensive application than has been affixed to it in any previous decision. This will be the case because the undisputed facts as we have stated them involve questions as to the operation of the Anti-Trust Act not hitherto presented in any case. Thus, even if the ownership of stock by the American Tobacco Company in the accessory and subsidiary companies and the ownership of stock in any of those companies among themselves were held, as was decided in *United States* v. *Standard Oil Co.*, to be a violation of the act and all relations resulting from such stock ownership were therefore set aside, the question would yet remain whether the principal defendant, the American Tobacco Company, and the five accessory defendants, even when divested of their stock ownership in other corporations, by virtue of the power which they would continue to possess, even although thus stripped, would amount to a violation of both the first and second sections of the act. Again, if it were held that the corporations, the existence whereof was due to a combination between such companies and other companies was a violation of the act, the question would remain whether such of the companies as did not owe their existence and power to combinations but whose power alone arose from the exercise of the right to acquire and own property would be amenable to the prohibitions of the act. Yet further: Even if this proposition was held in the affirmative the question would remain whether the principal defendant, the American Tobacco Company, when stripped of its stock ownership, would be in and of itself within the prohibitions of the act although that company was organized and took being before the Anti-Trust Act was passed. Still further, the question would yet remain whether particular corporations which, when bereft of the power which they possessed as resulting from stock ownership, although they were not inherently possessed of a sufficient residuum of power to cause them to be in and of themselves either a restraint of trade or a monopolization or an attempt to monopolize, should nevertheless be restrained because of their intimate connection and association with other corporations found to be within the prohibitions of the act. The necessity of relief as to all these aspects, we think, seemed to the Government so essential, and the difficulty of giving to the act such a comprehensive and coherent construction as

would be adequate to enable it to meet the entire situation, led to what appears to us to be in their essence a resort to methods of construction not compatible one with the other. And the same apparent conflict is presented by the views of the act taken by the defendants when their contentions are accurately tested. Thus the Government, for the purpose of fixing the illegal character of the original combination which organized the old American Tobacco Company, asserts that the illegal character of the combination is plainly shown because the combination was brought about to stay the progress of a flagrant and ruinous trade war. In other words, the contention is that as the act forbids every contract, and combination, it hence prohibits a reasonable and just agreement made for the purpose of ending a trade war. But as thus construing the act by the rule of the letter which kills, would necessarily operate to take out of the reach of the act some one of the accessory and many subsidiary corporations, the existence of which depend not at all upon combination or agreement or contract, but upon mere purchases of property, it is insisted in many forms of argument that the rule of construction to be applied must be the spirit and intent of the act and therefore its prohibitions must be held to extend to acts even if not within the literal terms of the statute if they are within its spirit because done with an intent to bring about the harmful results which it was the purpose of the statute to prohibit. So as to the defendants. While it is argued on the one hand that the forms by which various properties were acquired in view of the letter of the act exclude many of the assailed transactions from condemnation, it is yet urged that giving to the act the broad construction which it should rightfully receive, whatever may be the form, no condemnation should follow, because, looking at the case as a whole, every act assailed is shown to have been but a legitimate and lawful result of the exertion of honest business methods brought into play for the purpose of advancing trade instead of with the object of obstructing and restraining the same. But the difficulties which arise, from the complexity of the particular dealings which are here involved and the situation which they produce, we think grows out of a plain misconception of both the letter and spirit of the Anti-Trust Act. We say of the letter, because while seeking by a narrow rule of the letter to include things which it is deemed would otherwise be excluded, the contention really destroys the great purpose of the act, since it renders it impossible to apply the law to a multitude of wrongful acts, which would come within the scope of its remedial purposes by resort to a reasonable construction, although they would not be within its reach by a too narrow and unreasonable adherence to the strict letter. This must be the case unless it be possible in reason to say that for the purpose of including one class of acts which would not otherwise be embraced a literal construction although in con-

flict with reason must be applied and for the purpose of including other acts which would not otherwise be embraced a reasonable construction must be resorted to. That is to say two conflicting rules of construction must at one and the same time be applied and adhered to.

The obscurity and resulting uncertainty, however, is now but an abstraction because it has been removed by the consideration which we have given quite recently to the construction of the Anti-Trust Act in the *Standard Oil Case.* In that case it was held, without departing from any previous decision of the court, that as the statute had not defined the words restraint of trade, it became necessary to construe those words, a duty which could only be discharged by a resort to reason. We say the doctrine thus stated was in accord with all the previous decisions of this court, despite the fact that the contrary view was sometimes erroneously attributed to some of the expressions used in two prior decisions (the *Trans-Missouri Freight Association* and *Joint Traffic Cases*, 166 U.S. 290, and 171 U.S. 505). That such view was a mistaken one was fully pointed out in the *Standard Oil Case* and is additionally shown by a passage in the opinion in the *Joint Traffic Case* as follows (171 U.S. 568): "The act of Congress must have a reasonable construction, or else there would scarcely be an agreement or contract among business men that could not be said to have, indirectly or remotely, some bearing on interstate commerce, and possibly to restrain it." Applying the rule of reason to the construction of the statute, it was held in the *Standard Oil Case* that as the words "restraint of trade" at common law and in the law of this country at the time of the adoption of the Anti-Trust Act only embraced acts or contracts or agreements or combinations which operated to the prejudice of the public interests by unduly restricting competition or unduly obstructing the due course of trade or which, either because of their inherent nature or effect or because of the evident purpose of the acts, etc., injuriously restrained trade, that the words as used in the statute were designed to have and did have but a like significance. It was therefore pointed out that the statute did not forbid or restrain the power to make normal and usual contracts to further trade by resorting to all normal methods, whether by agreement or otherwise, to accomplish such purpose. In other words, it was held, not that acts which the statute prohibited could be removed from the control of its prohibitions by a finding that they were reasonable, but that the duty to interpret which inevitably arose from the general character of the term "restraint of trade" required that the words "restraint of trade" should be given a meaning which would not destroy the individual right to contract and render difficult if not impossible any movement of trade in the channels of interstate commerce — the free movement of which it was the purpose of the statute to protect. The soundness

of the rule that the statute should receive a reasonable construction, after further mature deliberation, we see no reason to doubt. Indeed, the necessity for not departing in this case from the standard of the rule of reason which is universal in its application is so plainly required in order to give effect to the remedial purposes which the act under consideration contemplates, and to prevent that act from destroying all liberty of contract and all substantial right to trade, and thus causing the act to be at war with itself by annihilating the fundamental right of freedom to trade which, on the very face of the act, it was enacted to preserve, is illustrated by the record before us. In truth, the plain demonstration which this record gives of the injury which would arise from and the promotion of the wrongs which the statute was intended to guard against which would result from giving to the statute a narrow, unreasoning and unheard of construction, as illustrated by the record before us, if possible serves to strengthen our conviction as to the correctness of the rule of construction, the rule of reason, which was applied in the *Standard Oil Case*, the application of which rule to the statute we now, in the most unequivocal terms, reëxpress and re-affirm.

Coming then to apply to the case before us the act as interpreted in the Standard Oil and previous cases, all the difficulties suggested by the mere form in which the assailed transactions are clothed become of no moment. This follows because although it was held in the *Standard Oil Case* that, giving to the statute a reasonable construction, the words "restraint of trade" did not embrace all those normal and usual contracts essential to individual freedom and the right to make which were necessary in order that the course of trade might be free, yet, as a result of the reasonable construction which was affixed to the statute, it was pointed out that the generic designation of the first and second sections of the law, when taken together, embraced every conceivable act which could possibly come within the spirit or purpose of the prohibitions of the law, without regard to the garb in which such acts were clothed. That is to say, it was held that in view of the general language of the statute and the public policy which it manifested, there was no possibility of frustrating that policy by resorting to any disguise or subterfuge of form, since resort to reason rendered it impossible to escape by any indirection the prohibitions of the statute.

Considering then the undisputed facts which we have previously stated, it remains only to determine whether they establish that the acts, contracts, agreements, combinations, etc., which were assailed were of such an unusual and wrongful character as to bring them within the prohibitions of the law. That they were, in our opinion, so overwhelmingly results from the undisputed facts that it seems only necessary to refer to the facts as we have stated them to demonstrate the correctness of this conclusion. Indeed, the history of the

combination is so replete with the doing of acts which it was the obvious purpose of the statute to forbid, so demonstrative of the existence from the beginning of a purpose to acquire dominion and control of the tobacco trade, not by the mere exertion of the ordinary right to contract and to trade, but by methods devised in order to monopolize the trade by driving competitors out of business, which were ruthlessly carried out upon the assumption that to work upon the fears or play upon the cupidity of competitors would make success possible. We say these conclusions are inevitable, not because of the vast amount of property aggregated by the combination, not because alone of the many corporations which the proof shows were united by resort to one device or another. Again, not alone because of the dominion and control over the tobacco trade which actually exists, but because we think the conclusion of wrongful purpose and illegal combination is overwhelmingly established by the following considerations: *a.* By the fact that the very first organization or combination was impelled by a previously existing fierce trade war, evidently inspired by one or more of the minds which brought about and became parties to that combination. *b.* Because, immediately after that combination and the increase of capital which followed, the acts which ensued justify the inference that the intention existed to use the power of the combination as a vantage ground to further monopolize the trade in tobacco by means of trade conflicts designed to injure others, either by driving competitors out of the business or compelling them to become parties to a combination — a purpose whose execution was illustrated by the plug war which ensued and its results, by the snuff war which followed and its results, and by the conflict which immediately followed the entry of the combination in England and the division of the world's business by the two foreign contracts which ensued. *c.* By the ever-present manifestation which is exhibited of a conscious wrongdoing by the form in which the various transactions were embodied from the beginning, ever changing but ever in substance the same. Now the organization of a new company, now the control exerted by the taking of stock in one or another or in several, so as to obscure the result actually attained, nevertheless uniform, in their manifestations of the purpose to restrain others and to monopolize and retain power in the hands of the few who, it would seem, from the beginning contemplated the mastery of the trade which practically followed. *d.* By the gradual absorption of control over all the elements essential to the successful manufacture of tobacco products, and placing such control in the hands of seemingly independent corporations serving as perpetual barriers to the entry of others into the tobacco trade. *e.* By persistent expenditure of millions upon millions of dollars in buying out plants, not for the purpose of utilizing them, but in order to close them up and render them useless for the pur-

poses of trade. *f*. By the constantly recurring stipulations, whose legality, isolatedly viewed, we are not considering, by which numbers of persons, whether manufacturers, stockholders or employés, were required to bind themselves, generally for long periods, not to compete in the future. Indeed, when the results of the undisputed proof which we have stated are fully apprehended, and the wrongful acts which they exhibit are considered, there comes inevitably to the mind the conviction that it was the danger which it was deemed would arise to individual liberty and the public well-being from acts like those which this record exhibits, which led the legislative mind to conceive and to enact the Anti-Trust Act, considerations which also serve to clearly demonstrate that the combination here assailed is within the law as to leave no doubt that it is our plain duty to apply its prohibitions.

In stating summarily, as we have done, the conclusions which, in our opinion, are plainly deducible from the undisputed facts, we have not paused to give the reasons why we consider, after great consideration, that the elaborate arguments advanced to affix a different complexion to the case are wholly devoid of merit. We do not, for the sake of brevity, moreover, stop to examine and discuss the various propositions urged in the argument at bar for the purpose of demonstrating that the subject-matter of the combination which we find to exist and the combination itself are not within the scope of the Anti-Trust Act because when rightly considered they are merely matters of intrastate commerce and therefore subject alone to state control. We have done this because the want of merit in all the arguments advanced on such subjects is so completely established by the prior decisions of this court, as pointed out in the *Standard Oil Case*, as not to require restatement.

Leading as this does to the conclusion that the assailed combination in all its aspects — that is to say, whether it be looked at from the point of view of stock ownership or from the standpoint of the principal corporation and the accessory or subsidiary corporations viewed independently, including the foreign corporations in so far as by the contracts made by them they became coöperators in the combination — comes within the prohibitions of the first and second sections of the Anti-Trust Act, it remains only finally to consider the remedy which it is our duty to apply to the situation thus found to exist.

The remedy.

Our conclusion being that the combination as a whole, involving all its coöperating or associated parts, in whatever form clothed, constitutes a restraint of trade within the first section, and an attempt to monopolize or a monopolization within the second section of the Anti-Trust Act, it follows that the relief which we are to afford must be wider than that awarded by the lower court, since that

court merely decided that certain of the corporate defendants constituted combinations in violation of the first section of the act, because of the fact that they were formed by the union of previously competing concerns and that the other defendants not dismissed from the action were parties to such combinations or promoted their purposes. We hence, in determining the relief proper to be given, may not model our action upon that granted by the court below, but in order to enable us to award relief coterminous with the ultimate redress of the wrongs which we find to exist, we must approach the subject of relief from an original point of view. Such subject necessarily takes a two-fold aspect — the character of the permanent relief required and the nature of the temporary relief essential to be applied pending the working out of permanent relief in the event that it be found that it is impossible under the situation as it now exists to at once rectify such existing wrongful condition. In considering the subject from both of these aspects three dominant influences must guide our action: 1. The duty of giving complete and efficacious effect to the prohibitions of the statute; 2, the accomplishing of this result with as little injury as possible to the interest of the general public; and, 3, a proper regard for the vast interests of private property which may have become vested in many persons as a result of the acquisition either by way of stock ownership or otherwise of interests in the stock or securities of the combination without any guilty knowledge or intent in any way to become actors or participants in the wrongs which we find to have inspired and dominated the combination from the beginning. Mindful of these considerations and to clear the way for their application we say at the outset without stopping to amplify the reasons which lead us to that conclusion, we think that the court below clearly erred in dismissing the individual defendants, the United Cigar Stores Company, and the foreign corporations and their subsidiary corporations.

Looking at the situation as we have hitherto pointed it out, it involves difficulties in the application of remedies greater than have been presented by any case involving the Anti-Trust Act which has been hitherto considered by this court: First. Because in this case it is obvious that a mere decree forbidding stock ownership by one part of the combination in another part or entity thereof, would afford no adequate measure of relief, since different ingredients of the combination would remain unaffected, and by the very nature and character of their organization would be able to continue the wrongful situation which it is our duty to destroy. Second. Because the methods of apparent ownership by which the wrongful intent was, in part, carried out and the subtle devices which, as we have seen, were resorted to for the purpose of accomplishing the wrong contemplated, by way of ownership or otherwise, are of such a character that it is difficult if not impossible to formulate a remedy which

could restore in their entirety the prior lawful conditions. Third. Because the methods devised by which the various essential elements to the successful operation of the tobacco business from any particular aspect have been so separated under various subordinate combinations, yet so unified by way of the control worked out by the scheme here condemned, are so involved that any specific form of relief which we might now order in substance and effect might operate really to injure the public and, it may be, to perpetuate the wrong. Doubtless it was the presence of these difficulties which caused the United States, in its prayer for relief, to tentatively suggest rather than to specifically demand definite and precise remedies. We might at once resort to one or the other of two general remedies — *a*, the allowance of a permanent injunction restraining the combination as a universality and all the individuals and corporations which form a part of or coöperate in it in any manner or form from continuing to engage in interstate commerce until the illegal situation be cured, a measure of relief which would accord in substantial effect with that awarded below to the extent that the court found illegal combinations to exist; or, *b*, to direct the appointment of a receiver to take charge of the assets and property in this country of the combination in all its ramifications for the purpose of preventing a continued violation of the law, and thus working out by a sale of the property of the combination or otherwise, a condition of things which would not be repugnant to the prohibitions of the act. But, having regard to the principles which we have said must control our action, we do not think we can now direct the immediate application of either of these remedies. We so consider as to the first because in view of the extent of the combination, the vast field which it covers, the all-embracing character of its activities concerning tobacco and its products, to at once stay the movement in interstate commerce of the products which the combination or its coöperating forces produce or control might inflict infinite injury upon the public by leading to a stoppage of supply and a great enhancement of prices. The second because the extensive power which would result from at once resorting to a receivership might not only do grievous injury to the public, but also cause widespread and perhaps irreparable loss to many innocent people. Under these circumstances, taking into mind the complexity of the situation in all of its aspects and giving weight to the many-sided considerations which must control our judgment, we think, so far as the permanent relief to be awarded is concerned, we should decree as follows: 1st. That the combination in and of itself, as well as each and all of the elements composing it, whether corporate or individual, whether considered collectively or separately, be decreed to be in restraint of trade and an attempt to monopolize and a monopolization within the first and second sections of the Anti-Trust Act. 2d. That the court below, in

order to give effective force to our decree in this regard, be directed to hear the parties, by evidence or otherwise, as it may be deemed proper, for the purpose of ascertaining and determining upon some plan or method of dissolving the combination and of recreating, out of the elements now composing it, a new condition which shall be honestly in harmony with and not repugnant to the law. 3d. That for the accomplishment of these purposes, taking into view the difficulty of the situation, a period of six months is allowed from the receipt of our mandate, with leave, however, in the event, in the judgment of the court below, the necessities of the situation require, to extend such period to a further time not to exceed sixty days. 4th. That in the event, before the expiration of the period thus fixed, a condition of disintegration in harmony with the law is not brought about, either as the consequence of the action of the court in determining an issue on the subject or in accepting a plan agreed upon, it shall be the duty of the court, either by way of an injunction restraining the movement of the products of the combination in the channels of interstate or foreign commerce or by the appointment of a receiver, to give effect to the requirements of the statute.

Pending the bringing about of the result just stated, each and all of the defendants, individuals as well as corporations, should be restrained from doing any act which might further extend or enlarge the power of the combination, by any means or device whatsoever. In view of the considerations we have stated we leave the matter to the court below to work out a compliance with the law without unnecessary injury to the public or the rights of private property.

While in many substantial respects our conclusion is in accord with that reached by the court below, and while also the relief which we think should be awarded in some respects is coincident with that which the court granted, in order to prevent any complication and to clearly define the situation we think instead of affirming and modifying, our decree, in view of the broad nature of our conclusions, should be one of reversal and remanding with directions to the court below to enter a decree in conformity with this opinion and to take such further steps as may be necessary to fully carry out the directions which we have given.

And it is so ordered.

Mr. Justice HARLAN concurred in holding that relief ought to be granted the United States, but dissented from that part of the opinion stating the form of relief to be granted, and also dissented from that part of the opinion in which the court reaffirms the doctrine of the "rule of reason" announced in the *Standard Oil Case, supra.*

NOTE. — For later suits, instituted by the United States, in which the court held acts to be in violation of the Anti-Trust Act, see

United States v. *St. Louis Terminal*, 224 U.S. 383; *United States* v. *Reading Co.*, 226 U.S. 324; *United States* v. *Patten*, 226 U.S. 525; *Eastern States Lumber Ass'n* v. *United States*, 234 U.S. 600; *Lawlor* v. *Loewe*, 235 U.S. 522 (see also 208 U.S. 274).

In *Nash* v. *United States.*, 229 U.S. 373, Mr. Justice HOLMES said (p. 376): "The objection to the criminal operation of the statute is thought to be warranted by *The Standard Oil Co.* v. *United States*, 221 U.S. 1, and *United States* v. *American Tobacco Co.*, 221 U.S. 106. Those cases may be taken to have established that only such contracts and combinations are within the act as, by reason of intent or the inherent nature of the contemplated acts, prejudice the public interests by unduly restricting competition or unduly obstructing the course of trade. 221 U.S. 179. And thereupon it is said that the crime thus defined by the statute contains in its definition an element of degree as to which estimates may differ, with the result that a man might find himself in prison because his honest judgment did not anticipate that of a jury of less competent men. The kindred proposition that 'the criminality of an act cannot depend upon whether a jury may think it reasonable or unreasonable. There must be some definiteness and certainty,' is cited from the late Mr. Justice BREWER sitting in the Circuit Court. *Tozer* v. *United States*, 52 Fed. Rep. 917, 919.

"But apart from the common law as to restraint of trade thus taken up by the statute the law is full of instances where a man's fate depends on his estimating rightly, that is, as the jury subsequently estimates it, some matter of degree. If his judgment is wrong, not only may he incur a fine or a short imprisonment, as here; he may incur the penalty of death. 'An act causing death may be murder, manslaughter, or misadventure according to the degree of danger attending it' by common experience in the circumstances known to the actor. 'The very meaning of the fiction of implied malice in such cases at common law was, that a man might have to answer with his life for consequences which he neither intended nor foresaw.' *Commonwealth* v. *Pierce*, 138 Massachusetts, 165, 178. *Commonwealth* v. *Chance*, 174 Massachusetts, 245, 252. 'The criterion in such cases is to examine whether common social duty would, under the circumstances, have suggested a more circumspect conduct.' 1 East P.C. 262. If a man should kill another by driving an automobile furiously into a crowd he might be convicted of murder however little he expected the result. See *Reg.* v. *Desmond*, and other illustrations in Stephen, Dig. Crim. Law, art. 223, 1st ed., p. 146. If he did no more than drive negligently through a street he might get off with manslaughter or less. *Reg.* v. *Swindall*, 2 C. & K. 230; *Rex* v. *Burton*, 1 Strange, 481. And in the last case he might be held although he himself thought that he was acting as a prudent man should. See *The Germanic*, 196 U.S. 589, 596. But without further

argument, the case is very nearly disposed of by *Waters-Pierce Oil Co.* v. *Texas* (No. 1), 212 U.S. 86, 109, where Mr. Justice Brewer's decision and other similar ones were cited in vain. We are of opinion that there is no constitutional difficulty in the way of enforcing the criminal part of the act." *Cf. International Harvester Co.* v. *Kentucky*, 234 U.S. 216.

UNITED STATES *v.* WINSLOW.

227 U.S. 202. 1912.

Mr. Justice Holmes. This is a writ of error to determine whether two counts in an indictment as construed by the District Court charge offences under the Sherman Act of July 2, 1890, chap. 647. 26 Stat. 209. They were held bad, on demurrer, by the District Court. 195 Fed. Rep. 578. The two counts allege substantially the same facts; the first laying them as a combination in restraint of the trade of the defendants themselves, the second as a conspiracy in restraint of the trade of others, shoe manufacturers.

The facts alleged are as follows: For the last twenty-five years practically all the shoes worn in the United States have been made by the help of machines, grouped as lasting machines, welt-sewing machines and outsole-stitching machines, heeling machines and metallic fastening machines, there being a large variety of machines in each group. (These machines of course are not alleged to do all the work of making finished shoes.) There is a great number of shoe factories, and because the machines are expensive and the best of them patented, the manufacturers have had to get them principally from the defendants. Before and up to February 7, 1899, the defendants Winslow, Hurd and Brown, through the Consolidated and McKay Lasting Machine Company, under letters patent, made sixty per cent. of all the lasting machines made in the United States; the defendants Barbour and Howe, through the Goodyear Shoe Machinery Company, in like manner made eighty per cent. of all the welt-sewing machines and outsole-stitching machines, and ten per cent. of all the lasting machines; and the defendant Storrow, (against whom the indictment has been dismissed), through the McKay Shoe Manufacturing Company, made seventy per cent. of all the heeling machines and eighty per cent. of all the metallic fastening machines made in the United States. The defendants all were carrying on commerce among the States with such of the shoe manufacturers as are outside Massachusetts, the State where the defendants made their machines.

On February 7, 1899, the three groups of defendants above named, up to that time separate, organized the United Shoe Machinery

Company and turned over to that company the stocks and business of the several corporations that they respectively controlled. The new company now makes all the machines that had been made in different places, at a single new factory at Beverly, Massachusetts, and directly, or through subsidiary companies, carries on all the commerce among the States that had been carried on independently by the constituent companies before. The defendants have ceased to sell shoe machinery to the shoe manufacturers. Instead, they only let machines, and on the condition that unless the shoe manufacturers use only machines of the kinds mentioned furnished by the defendants, or if they use any such machines furnished by other machinery makers, then all machines let by the defendants shall be taken away. This condition they constantly have enforced. The defendants are alleged to have done the acts recited with intent unreasonably to extend their monopolies, rights and control over commerce among the States; to enhance the value of the same at the expense of the public, and to discourage others from inventing and manufacturing machines for the work done by those of the defendants. The organization of the new company and the turning over of the stocks and business to it are alleged to constitute a breach of the Sherman Act.

It is to be observed that the conditions now inserted in the leases are not alleged to have been contemporaneous with the combination, or to have been contemplated when it was made. The District Court construed the indictment as confined to the combination of February 7, that is, simply to the merger of the companies without regard to the leases subsequently made, 195 Fed. Rep. 592, 594; and we have no jurisdiction to review this interpretation of the indictment. *United States* v. *Patten*, 226 U.S. 525. Hence the only question before us is whether that combination taken by itself was within the penalties of the Sherman Act. The validity of the leases or of a combination contemplating them cannot be passed upon in this case.

Thus limited the question does not require lengthy discussion, and a large part of the argument addressed to us concerned matters not open here. On the face of it the combination was simply an effort after greater efficiency. The business of the several groups that combined, as it existed before the combination, is assumed to have been legal. The machines are patented, making them is a monopoly in any case, the exclusion of competitors from the use of them is of the very essence of the right conferred by the patents, *Paper Bag Patent Case*, 210 U.S. 405, 429, and it may be assumed that the success of the several groups was due to their patents having been the best. As, by the interpretation of the indictment below, 195 Fed. Rep. 591, and by the admission in argument before us, they did not compete with one another, it is hard to see why the collective business should be any worse than its component parts. It is said that from

seventy to eighty per cent. of all the shoe machinery business was put into a single hand. This is inaccurate, since the machines in question are not alleged to be types of all the machines used in making shoes, and since the defendants' share in commerce among the States does not appear. But taking it as true we can see no greater objection to one corporation manufacturing seventy per cent. of three non-competing groups of patented machines collectively used for making a single product than to three corporations making the same proportion of one group each. The disintegration aimed at by the statute does not extend to reducing all manufacture to isolated units of the lowest degree. It is as lawful for one corporation to make every part of a steam engine and to put the machine together as it would be for one to make the boilers and another to make the wheels. Until the one intent is nearer accomplishment than it is by such a juxtaposition alone, no intent could raise the conduct to the dignity of an attempt.

NOTE. — On the rights of owners of patented articles see *Bement* v. *National Harrow Co.*, 186 U.S. 70; *Henry* v. *Dick Co.*, 224 U.S. 1, 30; *Standard Sanitary Mfg. Co.* v. *United States*, 226 U.S. 20; *United States* v. *Pacific & Arctic Co.*, 228 U.S. 87; *Bauer & Cie* v. *O'Donnell*, 229 U.S. 1.

On the rights of owners of copyrighted articles see *Bobbs-Merrill Co.* v. *Straus*, 210 U.S. 339; *Straus* v. *American Publishers' Association*, 231 U.S. 222.

On the rights of owners of proprietary medicines see *Dr. Miles Medical Co.* v. *Park & Sons Co.*, 220 U.S. 373.

BOOK V.

UNAUTHORIZED CORPORATE ACTION.

CHAPTER I.

COLLATERAL ATTACK UPON THE FORMATION OF A CORPORATION. HEREIN OF THE EXPRESSION "DE FACTO CORPORATION."

SECTION 1.

WHERE THERE HAVE BEEN DEALINGS BETWEEN THE PARTIES ON A CORPORATE BASIS.

CALLENDER *v.* PAINESVILLE R.R. CO.

11 Ohio State, 516. 1860.

The plaintiffs sought to recover for a breach of a written contract by the defendant, as an incorporated company, executed in its behalf by Van R. Humphrey, as its president.

A summons was served by leaving a true and certified copy at the principal business office of the defendant at Painesville.

Thereafter one George W. Steele filed a motion, stating that he was a member, and the secretary of the company, and asking that the petition be dismissed on several grounds, one being that said railroad company " is not an incorporated company."

This motion was granted in the lower court.

It appeared that there was a law under which such a railroad corporation could be formed, and that a certificate purporting to comply with the requirements of that law had been filed in the proper public office, and that the associates had done business, as though they were incorporated.

It was argued that the certificate did not comply with the requirements of law because the line of railroad was not defined with sufficient certainty.

Sutliff, J. [After intimating that the objection to the certificate was untenable.]

But in this case the original petition alleged that the defendant was a corporation. The contract upon which the action was brought,

a copy of which was appended to the petition, purported to be executed by the defendant, as a corporation; and the motion and the affidavit of the mover, disclosed, at most, only a defect in the act of incorporation. But the affidavit admits that the company had attempted in all respects to comply with the requisitions of the statute, and in fact obtained, by a supposed compliance on their part, the acceptance and record of their certificate by the secretary of state, a copy of which was to them a valid charter, as they supposed. And the affiant further states that he had acted as their secretary for some three years, and that the president of the company was then residing at Painesville, where the company then kept its office.

It thus appears that the members of the company obtained their charter, supposed themselves a legally incorporated company, and had continued to hold themselves out, and to act as such, to and with the public, and are still so acting. Nor is there any denial, either in the motion or affidavit of Steele, that their president, Humphrey, was not authorized by himself and others of the association, to execute said contract on behalf of the association, as an incorporated company.

Under such circumstances, the members of the company, and especially the officers of the company, are estopped to deny its existence as a corporation. However mistaken in fact, no person, whether artificial or natural, is permitted to so conduct and represent himself as to induce reasonable men, at his instance, to act upon the truth of such representations in their contracts and dealings with him, and to then deny the truth of such representations, to the prejudice of the party so having relied upon them.

In order for the company, or any member thereof, to so repudiate its conduct, and disprove the truth of its own representation, it is necessary for it, not only to show an honest mistake, but that such mistaken representation had not induced the adversary party, in the exercise of reasonable prudence on his part, to give the credit, make the contract, and act under it in confidence of the truth of such conduct and representations.

But in this case, not only has the association obtained a copy of the certificate, its charter of incorporation, and represented itself to the other party to be a corporation, by making the contract in that capacity, but it has continued to act in a corporate capacity down to the time of filing the motion; and the member so filing the motion states that he is still the officer of the corporation. It thus appears that, instead of contradicting the misrepresentation, before the contract was made, the company had not, even after making the contract, either in conduct or representation, ever denied their corporate character.

Under such circumstances, to suffer the defendants to repudiate their first conduct, and deny the truth of their representations, by

which the plaintiffs had been induced to contract with them, and upon which both parties had acted, would be in contravention of those principles of equity upon which the doctrine of estoppel rests, and its operative effect to prevent fraud depends.

We are, therefore, clearly of opinion that, at the time of the hearing of the motion, the company and its members who had so held themselves out to be a corporation, were estopped to deny that fact, for any defect whatsoever, if the same had in fact existed in their charter.

The judgment of the court of common pleas must, therefore, be reversed, and the cause remanded.

Judgment accordingly.

BOYCE *v.* TOWSONTOWN STATION.

46 Md. 359. 1877.

ASSUMPSIT against an alleged religious corporation. Defendants appeared by counsel, and pleaded, 1st, that the defendants are not and never were a body corporate, as alleged. Plaintiff offered in evidence an agreement or certificate of incorporation under a general statute. The statute required this document to be acknowledged before two justices of the peace, or a judge of the Circuit Court or of the Supreme Bench of Baltimore. It was acknowledged before a single justice of the peace. Plaintiff, to show user of the corporate name and franchise, offered in evidence a deed of land to said trustees; and a mortgage from said trustees to Crook and Hiss, trustees.

All the above evidence was rejected, and plaintiff excepted. Verdict and judgment for defendants. Plaintiff appealed.

STEWART, J. . . . But the appellant has undertaken to offer evidence of certain acts and proceedings of the appellee, referred to in the exceptions, to show that it held itself out as a corporation, and treated with the appellant as such, and is estopped from denying its liability as a corporation.

We think it would be extending the doctrine of *estoppel* to an extent, not justified by the principles of public policy, to allow it to operate through the conduct of the parties concerned, to create substantially a *de facto* corporation, with just such powers as the parties may by their acts give to it.

This would be substituting the dealings of the parties, for compliance with the requirements of the law, and giving to them the same effect through the aid of the Courts. Thus, virtually, through the Courts, recognizing the existence of the corporation, in manifest disregard of the written law.

It has been determined by this Court, that a corporation cannot

bind itself in excess of its powers. *Penna. Steam Navigation Co.* v. *Dandridge*, 8 G. & J. 319.

Whilst denying its capacity upon any principle of estoppel, to make contracts *ultra vires*, to bind itself; it would not be consistent with that theory to recognize its *existence ad libitum*, according to the conduct of the parties concerned.

Such a principle would seem to affix no other limit to the existence of the corporation *de facto*, or the extent of its power than the dealings of the parties, through the recognition of the Courts, might, upon the doctrine of estoppel, prescribe.

It would be more reasonable to hold corporations to their contracts, though *ultra vires*, of which they have received the benefit, or to prevent parties who have contracted with them, and received the benefit therefrom, from defeating their liability, on the ground of want of power in the corporation, as is held in quarters of high authority (see note and references in 2 Kent, 351), than to hold that corporations should be deemed to have existence, because they had so held themselves out.

The statute law of the State expressly requiring certain prescribed acts to be done to constitute a corporation, to permit parties indirectly, or upon the principle of estoppel, virtually to create a corporation for any purpose, or to have acts so construed, would be in manifest opposition to the statute law, and clearly against its policy, and justified upon no sound principle in the administration of justice.

Judgment affirmed.

NOTE. — Suppose a legislature has passed some law authorizing the formation of a corporation upon the performance of certain acts; that associates assume to comply with the law and, therefore, to be incorporated; and that it is claimed that they have not complied with the law. The court may hold (1) that what has been done amounts to a substantial compliance with the law; or (2) that the provision of law not complied with was a mere directory provision; or (3) that non-compliance with the provision of law in question was intended by the legislature to be only a cause for the forfeiture of the corporate existence.

The doctrine of *de facto* corporations is reached only when the court feels bound to hold that the defect in organization amounts to a failure substantially to perform a mandatory provision, the performance of which the legislature intended should be a condition precedent to incorporation. (See note on p. 30, *supra*.)

Whenever associates, who are not incorporated, assume to be incorporated, there is, in the nature of things, a composite unit, — the conception of a composite unit was not originated by the law. But the question remains whether this composite unit is to be treated by the court as a legal unit. It is for the legislature, not the court, to

create corporations; and, by our supposition, the associates have failed to perform a condition precedent to incorporation.

It is clear that if the State itself, in *quo warranto* (or similar proceeding), questions the incorporation of the associates, the court will declare them not to be a legal unit.

But if there is no such direct attack upon the incorporation of the associates, the question remains whether the court will permit collateral attack upon their incorporation, — whether, for example, the court will permit a private individual to show that the associates are not incorporated. It is to be frankly recognized that, in any case in which the court denies collateral attack, it predicates the same consequences upon unauthorized corporate action as it would have predicated upon authorized corporate action.

In every case in which associates who are not incorporated, assume to be incorporated, the composite unit thus formed might, with some propriety, be termed a corporation *de facto* (or a corporation by assumption). But the courts usually (although not always) use the term corporation *de facto* in a restricted sense. They incline to use the term only under the following circumstances: (1) when at the time of the alleged incorporation there was a law authorizing the formation of such a corporation as the associates attempted to form; (2) when the attempt to incorporate has been carried so far as to result in a colorable corporate organization; (3) when there has been user by the associates in the name of the alleged corporation of some of the powers which such a corporation would possess; and (4) when the person or persons asking that collateral attack be denied have acted in good faith.

Where the associates have caused a contract, in the name of the alleged corporation, to be made with an outsider, and the outsider sues the alleged corporation for breach thereof, and the circumstances are such that there was a corporation *de facto*, in the restricted sense of the term explained above, the authorities in *accord* with *Callender* v. *Painesville R.R. Co.*, *supra*, are very numerous. See 20 H.L.R. 476, note 33.

The rule laid down in *Boyce* v. *Towsontown Church* has been changed by statute. Section 6 of chap. 240 of the Laws of Maryland, 1908, provides: "Where an effort has been made in good faith to form, under the laws of this State a corporation formable thereunder, neither party to any transaction with it shall deny the legality of its incorporation or organization in any suit or proceeding growing out of such transaction."

It is a logical extension of the principle of *Callender* v. *Painesville R.R. Co.* that the outsider may hold any stockholder, director or officer of the alleged corporation to such liability as would have attached to him if the associates had been incorporated when the contract with the outsider was made. *Slocum* v. *Warren*, 10 R.I. 116. For further authorities see 20 H.L.R. 476, note 33.

If associates are incorporated, *de facto*, a sale by a receiver of the alleged corporation of its assets will pass whatever rights the associates have treated as rights of the corporation. *Matter of New York, Westchester & Boston Ry. Co.*, 193 N.Y. 72, 90.

BUSHNELL *v.* CONSOLIDATED ICE MACHINE CO.

138 Ill. 67. 1891.

Suit in chancery to have the Consolidated Ice Machine Company declared a copartnership, and its affairs settled between the complainant and defendants accordingly. In the court below, the demurrer was sustained and the bill dismissed.

The following facts appear from the bill: In 1884 the complainant and the individual defendants entered into a written agreement to form a corporation, with the above title, under the laws of the State; all the required steps were taken, up to and including the issuing of a certificate of the complete organization of such corporation by the Secretary of State; complainant was a director; and for several months secretary and soliciting agent, actively engaged in its business. In 1885 complainant became afflicted with *melancholia* and remained incapacitated for the transaction of business for about three years. During his sickness, the other directors sold some of his shares for non-payment of installments, the sale being without notice. Since the sale he has been excluded from all participation in the management of the business. After being restored to health, and before filing his bill, he made frequent demands to be restored to his rights in said corporation, but without avail.

Wilkin, J. The only allegation of the bill which is seriously insisted upon as furnishing a ground for the relief prayed is, "that the certificate of complete organization was never recorded in the office of the recorder of deeds for Cook County, where its principal office is located," the argument being, that in order to constitute the defendant company a corporation under the laws of this State that certificate must have been so recorded, and failing to become incorporated, its members are to be treated as partners. The section of the statute upon which the first proposition is based is as follows: "The Secretary of State shall thereupon issue a certificate of the complete organization of the corporation, making part thereof a copy of all papers filed in his office in and about the organization of the corporation, and duly authenticated under his hand and seal of State, and the same shall be recorded in a book for that purpose in the office of the recorder of deeds of the county where the principal office of such company is located. Upon the recording of said copy the corporation shall be deemed fully organized, and may proceed to business. Unless

such company shall be organized, and shall proceed to business, as provided in this act, within two years after the date of such license, then such license shall be deemed revoked and all proceedings thereunder void." The language of this section is not clear. While it says the *certificate* shall be recorded, it does not say who shall cause it to be done. It does not say the recording of the *certificate* shall be necessary to the complete organization of a corporation, but "upon the recording of the *said copy* the corporation shall be deemed fully organized, and may proceed to business." Conceding, however, by the word "copy" is meant "certificate," incorporators would have done all that is required of them when they had filed it with the proper officer for record. There is no allegation in this bill that it was not so filed. The averment is simply that it has "never been recorded," etc.

But assuming that a corporate existence *de jure* depends upon the filing of the certificate of complete organization in the office of the recorder of deeds of the county in which its principal office is located, and that the bill properly avers that it was not done in the case of the corporation in question, it by no means follows that it did not become a corporation *de facto* as between the complainant and defendants. From the facts set up in the bill it clearly appears that there was an honest attempt by the incorporators to organize a corporation authorized by the laws of this State. The necessary steps to perfect that organization were all taken as required by the statute, except that the final certificate was not recorded. It is shown by the bill that upon the issuing of that certificate its directors elected the proper officers and proceeded to the transaction of business as a corporation, and continued to act as such until the filing of this bill, a period of more than five years. That these facts establish a corporation *de facto* is settled by numerous decisions of this court. *President and Trustees, etc.*, v. *Thompson*, 20 Ill. 198; *Rice* v. *R.I. and A. R.R. Co.*, 21 id. 93; *Baker et al.* v. *Administrator*, 32 id. 79; *Ramsey* v. *Marine and Fire Ins. Co.*, 55 id. 311; *Cincinnati, Lafayette and Chicago Railroad Co.* v. *Danville and Vincennes Ry. Co.*, 75 id. 113; *Louisville, New Albany and Chicago Ry. Co.* v. *Shires*, 108 id. 617; *Hudson* v. *Green Hill Seminary Corporation*, 113 id. 618.

That plaintiff in error, if he had been sued by the Consolidated Ice Machine Company on his subscription to its capital stock, could not have questioned its corporate existence on the grounds alleged in his bill, is directly settled by several of the above cited decisions. It is equally clear that if, during the time he was a member of said corporation, it had been sued as such, neither he nor any other of its members could have been heard to say that no such corporation existed. *The general rule is, that one who deals with a corporation as existing* de facto, *is estopped to deny, as against it, that it has been legally organized. It is the settled rule in this State that the*

legal existence of a corporation de facto *cannot be questioned collaterally.* See cases *supra,* and *Renwick et al.* v. *Hall et al.*, 84 Ill. 162; *The People ex rel.* v. *Trustees of Schools,* 111 id. 171; *Keigwin et al.* v. *Drainage Comrs.*, 115 id. 347.

It seems impossible to find a reason for placing the complainant in this bill in a more favorable position to deny the existence of the corporation in question than a mere subscriber to its capital stock, or one who, as a third party, had dealt with it as a corporation, and we are of the opinion that he could not do so in this collateral proceeding.

NOTE. — See, *accord, Lincoln Park Chapter* v. *Swatek,* 204 Ill. 228; *Doty* v. *Patterson,* 155 Ind. 60; *Troutman* v. *Council Bluffs Co.*, 142 Iowa, 140; *Cannon* v. *Brush Electric Co.*, 96 Md. 446; *Allegheny Bank* v. *Bailey,* 147 Pa. 111; *Marsh* v. *Mathias,* 19 Utah, 350.

MINNESOTA GAS-LIGHT CO. *v.* DENSLOW.

46 Minn. 171. 1891.

VANDERBURGH, J. This action is brought upon a promissory note made by the defendant to the plaintiff for the sum of $1,000, dated February 15, 1888, and due in four months.

It is found by the trial court that the plaintiff at and since the date of the note has been an acting corporation, created and organized under the laws of the state of West Virginia and doing business as such in the state of Minnesota. But the defendant denies that the evidence warrants any such conclusion, and denies that the plaintiff has any legal capacity to sue in the courts of this state as a corporation *de jure* or *de facto.* It is clear, however, that a number of persons have associated themselves together claiming to be a corporation, and under the corporate name stated have filed articles, and have received the usual certificate of incorporation under the seal of the state, and have been transacting business under such corporate name. Nor is it disputed that corporations with the powers claimed to have been granted the plaintiff are authorized to be created under the laws of the state granting the charter. The defendant has contracted with the plaintiff by its corporate name. He is not in a position, therefore, to question its corporate character. Nor is it material for the purposes of this action what the strict legal relations of the associates may be as between themselves, whether corporators, partners, or otherwise jointly interested together and acting under the common corporate name.

NOTE. — The authorities, *accord,* are very numerous. See 20 H.L.R. 476, note 33.

SNIDER'S SONS' CO. *v.* TROY.

91 Ala. 224. 1890.

Action for goods sold by plaintiffs, in 1888, to, or on the order of, the Dispatch Publishing Co. The complaint alleged that said Company was at the time a partnership, and that defendant was one of the partners; that the Company claimed to be a corporation, but was never in fact incorporated. Plea, setting out certain steps taken, in 1885, by defendant and other persons to organize a corporation by the above name; also alleging that the debt now sued for was contracted by said Company as such corporation, and not otherwise; and that plaintiff dealt with it as a corporation, and not as a partnership or association of individuals. A demurrer to the plea was overruled.

Clopton, J. A corporation *de facto* exists, when from irregularity or defect in the organization or constitution, or from some omission to comply with the conditions precedent, a corporation *de jure* is not created, but there has been a colorable compliance with the requirements of some law under which an association might be lawfully incorporated for the purposes and powers assumed, and a *user* of the rights claimed to be conferred by the law — when there is an organization with color of law, and the exercise of corporate franchises. *Meth. E. Un. Church* v. *Pickett*, 48 N.J.L. 599.

The enabling law, under which a corporation for the purposes and objects of the Dispatch Publishing Company, and with the powers assumed, might have been lawfully created at that time, is contained in §§ 1803–1812 of the Code of 1876, and the amendatory acts, which authorize and provide for the incorporation of two or more persons desirous of forming a private corporation for the purpose of carrying on any industrial or other lawful business not otherwise specially provided for by law. Acts 1882–3, p. 40. The plea avers that defendant and two other named persons filed, September 2, 1885, with the judge of probate of Montgomery county a written declaration, signed by themselves, setting forth substantially the matters required by the statute, except the residences of the persons; that they organized by the election of three directors, and commenced and continued to do business in a corporate capacity, and were so doing business when the debt sued for was contracted. If the averments of the plea be true, the truth of which is admitted by the demurrer, the Dispatch Publishing Company was an association having capital stock divided into shares, organized by the election of officers, transacting business, and exercising franchises, functions and powers, after an attempted incorporation, as if it were a corporation *de jure* — a colorable compliance with the requirements of an existing and enabling law, and *user* of the rights claimed to be conferred thereby

— the essential elements of a corporation *de facto*. *Cen. Agr. & Mech. Asso.* v. *Ala. Gold Life Ins. Co.*, 70 Ala. 120.

Appellant seeks by the action to hold defendant, who was a member, liable as a partner for paper and other supplies sold to the Dispatch Publishing Company. Whether the shareholders in a corporation *de facto* are individually liable for the corporate debts, in the absence of fraud or a statute, is a question as to which the authorities are in direct antagonism. In Cook on Stock and Stockholders, § 233, the doctrine asserted is: "A corporate creditor, seeking to enforce the payment of his debt, may ignore the existence of the corporation, and may proceed against the supposed stockholders as partners, by proving that the prescribed method of becoming incorporated was not complied with by the company in question." The leading cases supporting this doctrine are *Bigelow* v. *Gregory*, 73 Ill. 197; *Abbott* v. *Omaha Smelt. Co.*, 4 Neb. 416; *Garrett* v. *Richardson*, 35 Ark. 144; *Ferris* v. *Thaw*, 72 Mo. 446; *Richardson* v. *Mayo*, 40 Ohio St. 9; *Coleman* v. *Coleman*, 78 Ind. 344. We have omitted reference to a few cases sometimes cited, for the reason, that either the question of liability as partners was not before the court, as in *Blanchard* v. *Kaull*, 44 Cal. 440; or the debt was contracted before any steps were taken, other than the mere filing of a certificate, toward organization, as in *Porpoise Fish Co.* v. *Bergen*, 13 Amer. & Eng. Cor. Cas. 1; or it was contracted after the expiration of the charter by its own limitation, without reorganization, as in *Nat. Bank* v. *Landon*, 45 N.Y. 410. In the case last cited, the shareholders entered into a special agreement, which by its terms created a partnership as to third persons.

In 2 Mor. on Corp. § 748, the doctrine is stated as follows: "If an association assumes to enter into a contract in a corporate capacity, and the party dealing with the association contracts with it as if it were a corporation, the individual members can not be charged as parties to the contract, either severally or jointly, or as partners." The following cases maintain the doctrine, that the members of a corporation *de facto* can not be held liable as partners for the corporate debts: *Fay* v. *Noble*, 7 Cush. 188; *First Nat. Bank* v. *Avery*, 117 Mass. 476; *Stout* v. *Zulick*, 48 N.J.L. 599; *Plan. Bank* v. *Padgett*, 69 Ga. 164; *Mer. & Man. Bank* v. *Stone*, 38 Mich. 779; *Humphrey* v. *Mooney*, 5 Cal. 282; *Cen. City Sav. Bank* v. *Walker*, 66 N.Y. 424; *Gartside Coal Co.* v. *Maxwell*, 22 Fed. Rep. 197; *Whiting* v. *Wyman*, 101 U.S. 392.

The plea and demurrer do not raise the question of the liability of the supposed stockholders as partners, where there has been no intention or attempt to incorporate; where they are acting as a body corporate, without even color of legislative authority — sheer usurpation. The plea avers that the debt sued for was contracted by the Dispatch Publishing Company, which is alleged to have been a *de facto* corporation, and that plaintiff sold the goods to, and contracted

with the company as a corporation, knowing that it was doing business as such. The question before us, and the only question we propose to decide, is whether, there being no fraud alleged, nor statute making the stockholders individually liable, a creditor who has dealt with a *de facto* corporation as a corporation, who has entered into contractual relations with it in its corporate name and capacity, can disregard the existence of the corporation, and, electing to treat it as a partnership, enforce the collection of his debt from the stockholders individually? The conflicting authorities afford aid in the solution of this question, only so far as their opinions may be in accord with settled principles and sustained by reason. Though it is an undecided question in this State, principles have been well settled, which materially bear upon the inquiry, and mark the way to a correct conclusion.

Corporations may exist either *de jure*, or *de facto*. If of the latter class, they are under the protection of the same law, and governed by the same legal principles as those of the former, so long as the State acquiesces in their existence and exercise of corporate functions. A private citizen, whose rights are not invaded, who has no cause of complaint, has no right to inquire collaterally into the legality of its existence. This can only be done in a direct proceeding on the part of the State, from whom is derived the right to exist as a corporation, and whose authority is usurped. This principle was clearly and emphatically declared in *Lehman* v. *Warner*, 61 Ala. 455, in the following language: "The corporation must, of necessity, be presumed to be rightfully in possession of the franchise, and rightfully to exercise the power, which the legislative grant confers. Individual right is not invaded, if the negative is true in fact, and there is usurpation. It is the State — the sovereign — whose rights are invaded, and whose rights are usurped. The individual could not create the corporation — could not grant, define, limit its powers; and no grant of these by the sovereign can lessen his rights. There can consequently be no cause of complaint by the citizen, and no right to inquire whether the corporate existence is rightful — *de jure* — or merely colorable." Taylor on Corp. § 145; 4 Amer. & Eng. Encyc. of Law, 198. The creditor can not proceed against the stockholders as partners, without proving non-compliance with prescribed conditions precedent, thus inquiring collaterally, not into the fact, but the legality of its existence.

It is also an established rule of general application, that a party who contracts with a corporation, exercising corporate powers, and performing corporate functions — existing as a *de facto* corporation — in its corporate name and capacity, will not be permitted, in a suit on the contract, to deny and disprove the rightfulness of its existence. 4 Amer. & Eng. Encyc. of Law, 198. In *Smartwood* v. *Michigan Air Line R.R. Co.*, 24 Mich. 390, COOLEY, J., declares the rule as

follows: "Where there is thus a corporation *de facto*, with no want of legislative power to its due and legal existence, when it is proceeding in the performance of corporate functions, and the public are dealing with it on the supposition that it is what it professes to be, and the questions are only whether there has been exact regularity and strict compliance with the provisions of the law relating to corporations; it is plainly a dictate alike of justice and public policy, that in controversies between the *de facto* corporation and those who have entered into contract relations with it, as corporators or otherwise, that such questions should not be suffered to be raised."

The general rule is thus stated by BRICKELL, C.J.: "Whoever contracts with a corporation in the use of corporate powers and franchises, and within the scope of such powers, is estopped from denying the existence of the corporation, or inquiring into the regularity of the corporate organization, when an enforcement of the contract, or of rights arising under it, is sought." *Cahall* v. *Citizens' M.B. Asso.*, 61 Ala. 232; *Central Agr. & Mech. Asso.* v. *Ala. Gold Life Ins. Co.*, 70 Ala. 120; *Schloss* v. *Montg. Trade Co.*, 87 Ala. 411.

It is conceded that the rule has been invoked and applied most frequently in suits against the stockholders or corporation, or persons who have contracted with it, where the stockholder, corporation or person is seeking to avoid a liability by denying the legality of the corporate organization. But why should it not be applicable in other cases? Why should a stockholder be estopped, in a suit by a creditor of an insolvent corporation, to require payment of his unpaid subscription, and the creditor allowed to ignore the existence of the corporation, and proceed against the stockholder as a partner? Why should not the estoppel be mutual? Taylor, in his work on Corporations, § 148, having stated the general rule, that a corporation when sued on its contract, and the person who contracted with it, when sued on his contract, is each estopped to deny its legal incorporation, adds: "Furthermore, persons who have contracted with a corporation as such, and have acquired claims against it, are estopped from denying its corporate existence for the purpose of holding its shareholders liable as partners." And the same rule was applied in several of the cases cited above, in which a corporate creditor was seeking to hold the stockholder liable as a partner for a corporate debt. The abrogation of the foregoing well established rule is the logical sequence of maintaining a suit by a creditor of a *de facto* corporation, charging the stockholders as partners.

Another consideration. § 8 of Article XIV of the Constitution declares: "In no case shall any stockholder be individually liable, otherwise than for the unpaid stock owned by him or her." Exemption from liability, other than for unpaid stock, is the declared policy of the State. It can not be imposed by legislation, or by the judgment of a court. In view of the constitutional provision, it is mani-

fest that the share-holders of the Dispatch Publishing Company intended, by the attempt to incorporate, to avoid individual liability for the debts contracted by the corporation. When a party deals and contracts with a corporation as corporators, exemption from individual liability enters as an element of the contract. It is true that the liability of persons associated in an enterprise or adventure is not determinable by the name they assume, but by the legal consequence of their acts. A partnership may arise as to third persons, by mere operation of law, and contrary to the intention of the parties; but, to have this effect, the elements essential to constitute a partnership as to third persons must exist. A corporation *de facto* has an independent *status*, recognized by the law as distinct from that of its members. A partnership is not the necessary legal consequence of an abortive attempt at incorporation. As said in *Fay* v. *Noble*, *supra*, "Surely, it can not be, in the absence of all fraudulent intent, that such a legal result follows as to fasten on parties involuntarily, for such a cause, the enlarged liability of co-partners, a liability neither contemplated nor assented to by them. The statement of the proposition carries with it a sufficient refutation."

Maintenance of such suit involves judicial nullification of franchises and powers enjoyed and exercised by a *de facto* corporation, as a distinct entity recognized by the law, acquiesced in by the State; defeats the corporate character of the contract, changes the relation from that of stockholders to that of partners; substitutes other and new parties to the contract, and effects the imposition of an enlarged liability, which they did not assume, but intended to avoid; so understood by the creditor, when he contracted the debt with the corporation as such. The contract is valid and binding on the corporation, which the creditor trusted. No injustice is done him, for all his rights and remedies are preserved by the principle that the corporation and the share-holder are estopped from denying its legal existence, as against him. It will not answer to say that he is not repudiating, but enforcing the contract. He repudiates the party — the corporation — with which he made the contract, and seeks its enforcement against parties who never entered into contractual relations with him.

The doctrine that a creditor who has dealt with a *de facto* corporation, in its corporate capacity, can not charge the stockholders as partners with the corporate debt, there being no fraudulent intent alleged and proved, seems to us to be sustained by the weight of authority, maintained by stronger reasoning, consistent with well settled principles, and in harmony with the policy of the State.

Affirmed.

NOTE. — See, *accord*, *Humphreys* v. *Mooney*, 5 Colo. 282; *Stafford Bank* v. *Palmer*, 47 Conn. 443; *Planters' Bank* v. *Padgett*, 69 Ga.

164; *Tulane Improvement Co.* v. *Chapman*, 129 La. 562; *Jennings* v. *Dark*, 175 Ind. 332; *Trowbridge* v. *Scudder*, 11 Cush. (Mass.) 83; *Merchants Bank* v. *Stone*, 38 Mich. 779; *Finnegan* v. *Noerenberg*, 52 Minn. 239; *Hogue* v. *Capital National Bank*, 47 Neb. 929; *Larned* v. *Beal*, 65 N.H. 184; *Stout* v. *Zulick*, 48 N.J.L. 599; *Whitford* v. *Laidler*, 94 N.Y. 145, 151 (see also *Central Bank* v. *Walker*, 66 N.Y. 424; but *cf. Fuller* v. *Rowe*, 57 N.Y. 23); *Rowland* v. *Meader Co.*, 38 Ohio, 269; *Mason* v. *Stevens*, 16 S.D. 320; *Shields* v. *Clifton Co.*, 94 Tenn. 123; *American Co.* v. *Heidenheimer*, 80 Tex. 344; *Mitchell* v. *Jensen*, 29 Utah, 346; *Clausen* v. *Head*, 110 Wis. 405 (but *cf. Bergeron* v. *Hobbs*, 96 Wis. 641).

RICHARDSON FUELING CO. *v.* SEYMOUR.

235 Ill. 319. 1908.

ACTION of assumpsit against John Seymour, and others, to recover for coal sold.

MR. JUSTICE DUNN delivered the opinion of the court.

The account sued on was for coal furnished to the steamer *Puritan*. There was evidence tending to show that the steamer was operated, at the time the account accrued, by the Seymour Transportation Company, purporting to be a corporation organized under the laws of this State. The certificate of incorporation of the company, however, had never been filed for record in the county where its principal office was located, and the ground of the alleged liability of the appellants is their assumption and exercise of corporate powers and use of the corporate name without complying with the provision of § 4 of the Incorporation Act, in regard to the recording of the certificate of complete organization of the corporation. The appellants were original subscribers to the capital stock of the supposed corporation, and were stockholders, directors and officers thereof until after the transactions here in controversy. The evidence tends to show that the appellants lived in Manistee, Michigan, and that E. W. Seymour, another original subscriber, stockholder, director and officer of the company, was its manager, who had actual charge of the business of the steamer in Chicago, where the coal was furnished. It is argued that the debt to the appellee was made by the latter alone, and that appellants did not participate therein in any way and had no connection therewith. In the case of *Bigelow* v. *Gregory*, 73 Ill. 197, the effect upon the liability of incorporators of a failure to comply with the provisions of the statute of Wisconsin in regard to the filing of their certificate and publication of articles of association was under consideration, and it was there held that the incorporators, under such circumstances, were liable as partners.

And in *Loverin* v. *McLaughlin*, 161 Ill. 417, it was held that a company which is not a corporate body is a partnership, composed not merely of the directors, but of all the subscribers to the articles of association who had not withdrawn. So in *Gunderson* v. *Illinois Trust and Savings Bank*, 199 Ill. 422, it is said that if the association there concerned was not a corporate body it was a partnership of individuals, who would be liable as partners for its debts. Proof of a corporation *de facto* does not relieve directors and officers of the corporation from the liability imposed by the statute. A corporation *de jure* must be shown, to escape that liability. *Butler Paper Co.* v. *Cleveland*, 220 Ill. 128. Independent of any liability under § 18 of the Incorporation Act, the appellants were liable as partners if the proof showed the delivery of the coal. There was evidence tending to show its delivery, and with the weight of the evidence we have nothing to do.

NOTE. — Section 18 of the Incorporation Act, to which reference is made in the opinion, is as follows: "If any person or persons being, or pretending to be, an officer or agent, or board of directors, of any stock corporation, or pretended stock corporation, shall assume to exercise corporate powers, or use the name of any such corporation, or pretended corporation, without complying with the provisions of this Act . . . then they shall be jointly and severally liable for all debts and liabilities made by them, and contracted in the name of such corporation, or pretended corporation."

In *Bigelow* v. *Gregory*, 73 Ill. 197, the court said (pp. 200, 201): "The defendants are seeking escape from individual liability; let them show that they have complied with the statute which enables them to do so, at least substantially. . . . There would seem to be a distinction between the case where, in a suit between a corporation and a stockholder or other individual, the plea of *nul tiel corporation* is set up to defeat a liability which the one may have contracted with the other, and the case of a suit against individuals who claim exemption from individual liability, on the ground of their having become a corporation formed under the provisions of a general statute. In the latter case, a stricter measure of compliance with statutory requirements will be required, than in the former."

See, in *accord* with the principal case, *Garnett* v. *Richardson*, 35 Ark. 144. See also *Vanhorn* v. *Corcoran*, 127 Pa. 255.

As to the law of Missouri *cf. Martin* v. *Fewell*, 79 Mo. 401, 410, with *Bank* v. *Rockefeller*, 195 Mo. 15.

A liability may be expressly imposed in such case by statute. See *Humphreys* v. *Drew*, 59 Fla. 295; *Berkson* v. *Anderson*, 115 Iowa, 674; *Ragland* v. *Doolittle*, 100 Miss. 498.

UNITED STATES EXPRESS CO. *v.* BEDBURY.

34 Ill. 459. 1864.

THIS was a proceeding by garnishment, commenced by Bedbury against the United States Express Company.

MR. CHIEF JUSTICE WALKER. It is insisted, as a ground of reversal, that there is nothing in the record to show that plaintiff in error was a corporation. . . .

It is insisted that the service of the garnishee process upon the company was insufficient to sustain the judgment. By the amended return it appears, that if plaintiff in error is a corporation the service was sufficient, and in strict compliance with the statute. It states, that the president of the company not residing in the county in which the suit was pending, that the writ was served upon the company as garnishee, by reading and delivering a copy thereof to Henry Colvin and James C. Fargo, agents of the company, and on D. B. Cooke, their clerk.

This, then, presents the question whether this is a corporation. Plaintiff in error appeared to the suit by the name of the "United States Express Company," and this is a sufficient admission that such is their name. In the case of *Henriques* v. *Dutch West India Company*, 28 Raym. 1535, it was held, that the name of the company imported a corporation. And the same rule has been announced or recognized in the courts of New York in the case of *Stoddard* v. *Onondaga Conference*, 12 Barb. 570; *Kennedy* v. *Cotton*, 28 id. 62.

These cases show that such a name imports a corporation. It seems to comport with reason, that when an association of persons assume a name, which implies a corporate body, and exercise corporate powers, [they] should not be heard to deny that they are a corporation. When they do act and contract they are estopped from denying their corporate liability.

Judgment affirmed.

NOTE. — See, *accord, Perine* v. *Grand Lodge*, 48 Minn. 82; *Corey* v. *Morrill*, 61 Vt. 598.

So, where the associates have assumed to be still incorporated after the expiration of the period of incorporation. *Miller* v. *Coal Co.*, 31 W.Va. 836.

So, where the associates have assumed to be incorporated although there was no law under which such a corporation, as they assumed to have formed, could have been formed. *McDonnell* v. *Alabama Insurance Co.*, 85 Ala. 401; *McCarthy* v. *Lavasche*, 89 Ill. 270; *Shadford* v. *Detroit Ry.*, 130 Mich. 300; *Gardner* v. *Minneapolis Co.*, 73 Minn. 517.

SEATON *v.* GRIMM.

110 Iowa, 145. 1899.

THE defendants are stockholders in a corporation known as the "Farmers' Co-Operative Creamery Association of Millersburg, Iowa." Plaintiffs hold a judgment against the corporation, and bring this action against the stockholders to recover the balance due on their judgment, after exhausting all property of the corporation, — alleging that while the corporation was organized on the twenty-sixth of April, 1893, it did not publish notice of incorporation until November 8, 1893. By way of estoppel, defendants pleaded that plaintiffs and defendants were and are the identical persons who signed, acknowledged, and filed for record the original articles of incorporation, and that, by reason of being such incorporators and stockholders, plaintiffs are estopped from denying the legality of the corporation. Plaintiffs demurred to the whole answer.

DEEMER, J. The estoppel pleaded by defendants is said to be insufficient, because there is no allegation or claim of injury. That it is injury defendants seek to avoid in their plea of estoppel is apparent. Granting, for the purpose of argument, that, technically speaking, no estoppel is pleaded, the broader question remains, may plaintiffs, who are and were, with defendants, the original stockholders in the corporation, and who dealt with the corporation as a legal entity, plead failure to comply with the statutes with reference to publicity, and thus take advantage of their own wrong? The principle that no one may take advantage of his own wrong is firmly imbedded in our jurisprudence, and has been applied to an almost infinite number and character of cases. That doctrine is peculiarly applicable to the case at bar. Here plaintiffs dealt with a *de facto* corporation and accepted notes and mortgages signed by the corporation as such. They were among the original incorporators, and, if notice was not given as required by statute, the fault is theirs; at least, they are as blamable as the defendants. Surely, they cannot be heard to say that, by reason of not having complied with the law, they are entitled to hold defendants liable for failure to do the very things that they were as much bound to do as the defendants. Such a rule would allow them to profit from their own wrong. *Bushnell* v. *Ice Machine Co.*, 138 Ill. Sup. 67 (27 N.E. Rep. 596); *Heald* v. *Owen*, 79 Iowa, 23.

NOTE. — So, even if the law under which the alleged corporation was formed is unconstitutional, this is no defense in an action to recover on a subscription to its stock, made after the alleged incorporation. *Evansville Co.* v. *Evansville*, 15 Ind. 395, 416; *East Pascagoula Co.* v. *West*, 13 La. Ann. 545; *Weinman* v. *Wilkinsburg Co.*, 118 Pa. 192.

WINGET *v.* QUINCY BUILDING ASS'N.

128 Ill. 67. 1889.

A BILL in chancery, brought by complainants to enjoin the sale of certain premises under the powers of sale contained in two deeds of trust executed by the complainants to the Quincy Building and Homestead Association to secure the repayment of money loaned.

MR. JUSTICE BAILEY delivered the opinion of the court: —

One of the grounds upon which the complainants seek to be relieved from the legal consequences of Winget's membership in the Quincy Building and Homestead Association, and from the obligations created by the notes and deeds of trust executed by them to said association is, that the association has no valid legal existence. In support of this contention they insist that the act of 1872 under which said association was organized is unconstitutional and void, because the entire scope of the act, as is claimed, is not sufficiently expressed in the title. On this point it is sufficient to say that whatever may be the fact in relation to the valid legal existence of said association as a corporation, the complainants are not in a position in which they can be permitted to challenge its validity. A party who has contracted with a corporation *de facto* as such, cannot be permitted, after having received the benefits of his contract, to allege any defect in the organization of such corporation, as affecting its capacity to enforce such contract, but all such objections, if valid, are available only on behalf of the sovereign power of the State. 2 Morawetz on Corporations, § 750, and authorities cited in note. And this rule applies even where the corporation is organized under a law alleged to be unconstitutional. *Friedland* v. *Pennsylvania Central Ins. Co.*, 94 Pa. St. 504; *McCarthy* v. *Lavasche*, 89 Ill. 270; *Dows* v. *Naper*, 91 Id. 44; Morawetz on Corporations, §§ 759, 760.

NOTE. — See, *accord*, *Platte Bank* v. *Harding*, 1 Neb. 461; *Coxe* v. *State*, 144 N.Y. 396; *Freeland* v. *Penn. Co.*, 94 Pa. 504; *Building Ass'n* v. *Chamberlain*, 4 S.D. 271; *Black River Co.* v. *Holway*, 85 Wis. 344.

See, *contra*, *Green* v. *Graves*, 1 Doug. (Mich.) 351; *Owen* v. *Bank of Sandstone*, 2 Doug. 134, note; *Skinner* v. *Wilhelm*. 63 Mich. 568 (but *cf.* *Burton* v. *Schildbach*, 45 Mich. 504).

STOUTIMORE *v.* CLARK.

70 Mo. 471. 1879.

APPEAL from Clay Circuit Court.

The action, *Stoutimore* v. *Clark*, was brought to establish a certain charge as a lien upon the land formerly the property of Joseph Y. Clark, now deceased; and to obtain a decree for the sale of the land to satisfy the charge. By order of court, the Missouri City Savings Bank, and John Chrisman, were made defendants in said suit. The Bank filed an answer alleging a lien under a judgment against Clark, rendered March 27, 1874. This judgment was founded on a note of said Clark payable to the order of the Missouri City Savings Bank, at the office of said bank. Chrisman filed an answer alleging a lien on part of the land under a trust deed, executed by Clark September 19, 1874, to secure a loan. Chrisman also filed a cross answer to the answer of the Missouri City Savings Bank, alleging that said bank was not a corporation. Upon the trial, to prove the corporate organization and existence of the bank, a certificate signed by the alleged president and secretary was offered in evidence To the admission of this certificate Chrisman objected, on the ground that it did not comply with the statutory requirements. This objection was sustained, and the evidence was excluded. The Circuit Court ordered the sale of the land; and directed that the judgment of the bank should be paid out of the proceeds before the claim of Chrisman. Chrisman appealed from an order denying his motion for a new trial.

NORTON, J. It is insisted by counsel that, inasmuch as, on the trial of the cause, the Missouri City Savings Bank failed to introduce evidence establishing the fact that it was a corporation, the said judgment rendered in its favor was a nullity and did not create a lien upon the real estate of Clark.

We think the view thus taken is unsound. The note upon which said judgment was rendered is as follows: —

"$4,000. MISSOURI CITY, July 1st, 1870.

"Four months after date we promise to pay to the order of the Missouri City Savings Bank, Four Thousand Dollars, negotiable and payable at the office of the Missouri City Savings Bank, Missouri City, Mo., without defalcation or discount, for value received, with interest at ten per cent per annum from maturity until paid.

"GILMER, CLARK & CO.
"J. Y. CLARK.
"R. G. GILMER, Security."

We think it clear that in the suit instituted by the bank on this note Clark would not have been allowed to deny the corporate existence of the bank for the reason that by executing the note he admitted the fact that it was a corporation, which estopped him from

disputing it. This principle was distinctly enunciated in the case of *National Insurance Co.* v. *Bowman*, 60 Mo. 252, following the case of *Farmers and Merchants Insurance Co.* v. *Needles*, 52 Mo. 17, and the case of *O. & M. R.R. Co.* v. *McPherson*, 35 Mo. 13. In the case of *City of St. Louis* v. *Shields et al.*, 62 Mo. 247, it was expressly held that the obligors on a bond given to a corporation by making and signing the instrument admit the corporate capacity of the obligee, and in a suit on such bond cannot plead *nul tiel corporation*. The cases cited indisputably establish that Clark, the obligor in the note upon which the judgment rests, could not have set up as a defense that the bank was not a corporation, and it therefore follows that the judgment, so far from being a nullity as counsel contend, was rightful and proper, and from the time of its rendition became a lien on the real estate of Clark in Clay County, and was conclusive and binding not only on him but upon all claiming through or under him.

NOTE. — If A contracts with the associates as a corporation, does this, without more, give them a right to sue A as a corporation? Some courts have been careful not to commit themselves to any larger doctrine than that the contract is sufficient to make a *primâ facie* case of incorporation. See *Montgomery R.R.* v. *Hurst*, 9 Ala. 513; *Gaines* v. *Bank of Mississippi*, 12 Ark. 769; *Brown* v. *Mortgage Co.*, 110 Ill. 235, 241; *Williams* v. *Cheney*, 3 Gray (Mass.) 215, 220; *Topping* v. *Bickford*, 4 Allen (Mass.) 120, 121; *Williamsburg Co.* v. *Frothingham*, 122 Mass. 391; *French* v. *Donohue*, 29 Minn. 111, 113; *Johnston Co.* v. *Clark*, 30 Minn. 308; *Den* v. *Van Houten*, 5 Halst. (N.J.) 270; *Ryan* v. *Martin*, 91 N.C. 464. Some courts have gone further, and have said that where the assumption is naked the associates may not sue as a corporation. See *Schuetzen Bund* v. *Agitations Verein*, 44 Mich. 313; *Methodist Church* v. *Pickett*, 19 N.Y. 482. On the other hand, there is a cloud of dicta to the effect that if A contracts with the associates as a corporation, he is estopped to show that they were not authorized to act as a corporation. Such a dictum seems first to have been made in *Dutchess Manufactory* v. *Davis*, 14 Johns. (N.Y.) 238 (1817), in which the court relied on *Henriques* v. *Dutch West India Co.*, 2 Ld. Raym. 1532. See the explanation of this latter case by NELSON, J., in *Welland Canal Co.* v. *Hathaway*, 8 Wend. (N.Y.) 480, 481. While the language of these dicta is unrestrained, and, taken at its face value, covers the case of naked assumption, it is clear that in nearly all of the cases no question as to naked assumption was present to the minds of the judges. Such dicta will be found in *McCullough* v. *Talladega Co.*, 46 Ala. 376; *Lehman* v. *Warner*, 61 Ala. 455, 466; *Greenville* v. *Greenville Co.*, 125 Ala. 625, 642; *Searcy* v. *Yarnell*, 47 Ark. 269, 281; *Plummer* v. *Struby-Estabrooke Co.*, 23 Colo. 190, 193; *School District* v. *Alderson*, 6 Dak. 145, 149; *Booske* v. *Gulf Ice Co.*, 24 Fla. 550, 559; *Petty* v. *Brunswick Ry. Co.*, 109 Ga. 666, 674; *Lombard* v. *Chicago Congregation*, 64 Ill. 477,

487; *John* v. *Farmers' Bank*, 2 Blackf. (Ind.) 367, 369; *Ensey* v. *Cleveland Co.*, 10 Ind. 178; *Beaver* v. *Hartsville University*, 34 Ind. 245; *Jones* v. *Kokomo Ass'n*, 77 Ind. 340; *Cravens* v. *Eagle Co.*, 120 Ind. 6; *Depew* v. *Bank of Limestone*, 1 J. J. Marsh. (Ky.) 378, 380; *Blanc* v. *Germania Bank*, 114 La. 739; *Meadow Dam Co.* v. *Gray*, 30 Me. 547, 549; *Worcester Institution* v. *Harding*, 11 Cush. (Mass.) 285; *Mason* v. *Crowder*, 98 Mo. 352; *Congregational Soc.* v. *Perry*, 6 N.H. 164; *Nashua Co.* v. *Moore*, 55 N.H. 48, 53; *Dutchess Mfg.* v. *Davis*, 14 Johns. (N.Y.) 238; *Williams* v. *Bank of Michigan*, 7 Wend. (N.Y.) 539, 542; *Commercial Bank* v. *Pfeiffer*, 108 N.Y. 242, 254; *All Saints' Church* v. *Lovett*, 1 Hall (N.Y.) 191, 198; *Newburg Co.* v. *Weare*, 27 Ohio St. 343, 354; *Grant* v. *Clay Co.*, 80 Pa. St. 208, 218; *Myers* v. *Croft*, 13 Wall. (U.S.) 291, 295; *Casey* v. *Galli*, 94 U.S. 673, 680; *Close* v. *Glenwood Cemetery*, 107 U.S. 466, 477; *Andes* v. *Ely*, 158 U.S. 312, 322; *Wallace* v. *Hood*, 89 Fed. 11, 20; *Wells Co.* v. *Avon Mills*, 118 Fed. 190, 194. Of these dicta, those entitled to most weight are in *Williams* v. *Bank of Michigan*, 7 Wend. (N.Y.) 539, 542, and *Commercial Bank* v. *Pfeiffer*, 108 N.Y. 242. See also *Calkins* v. *Bump*, 120 Mich. 335, 342; *Rafferty* v. *Bank of Jersey City*, 33 N.J.L. 368. And there are a few decisions, in *accord* with the principal case, the result of which logically involves the proposition that one who has contracted with the associates as a corporation is, without more, estopped to defend on the ground that the associates were not authorized to act as a corporation. *Blake* v. *Holley*, 14 Ind. 383; *Meikel* v. *German Soc.*, 16 Ind. 181; *Hasselman* v. *U.S. Mortgage Co.*, 97 Ind. 365; *Liverpool Co.* v. *Hunt*, 11 La. Ann. 623; *Franz* v. *Teutonia Ass'n*, 24 Md. 259 (but see *Boyce* v. *Church*, *supra*); *Farmers' Co.* v. *Needles*, 52 Mo. 17; *Nat'l Ins. Co.* v. *Bowman*, 60 Mo. 252; *Studebaker Co.* v. *Montgomery*, 74 Mo. 101.

Where the period of incorporation has expired, and A thereafter contracts with the associates as a corporation, they may sue, as a corporation, for breach of A's contract. *West Missouri Co.* v. *Kansas City Co.*, 161 Mo. 595; *Miller* v. *Coal Co.*, 31 W.Va. 836, 841; *Citizens' Bank* v. *Jones*, 117 Wis. 446. *Contra*, *White* v. *Campbell*, 5 Humph. (Tenn.) 38.

IMPERIAL BUILDING CO. *v.* CHICAGO OPEN BOARD OF TRADE.

238 Ill. 100. 1909.

APPELLANT sought to recover from appellee upon a warrant of attorney contained in a lease in which appellant was lessor and appellee lessee.

Appellant was organized under the general Incorporation Act for the purpose of leasing certain land in Chicago, erecting a building

thereon for the accommodation of tenants, making leases, collecting rents and doing all things incident to the management of said property.

MR. JUSTICE FARMER delivered the opinion of the court:

It is not controverted that corporations cannot be organized in this State for the purpose of acquiring and holding real estate. The first section of our general Incorporation Act (Hurd's Stat. 1905, chap. 32) reads: "That corporations may be formed in the manner provided by this act for any lawful purpose except banking, insurance, real estate brokerage, the operation of railroads and the business of loaning money: *Provided*, that horse and dummy railroads, and organizations for the purchase and sale of real estate for burial purposes only, may be organized and conducted under the provisions of this act: *And provided further*, that corporations formed for the purpose of constructing railroad bridges shall not be held to be railroad corporations." § 5 provides that corporations formed under the act "may own, possess and enjoy so much real and personal estate as shall be necessary for the transaction of their business, and may sell and dispose of the same when not required for the uses of the corporation." It is further provided in said § 5 that real estate acquired by the corporation in satisfaction of an indebtedness or liability to it, unless necessary and suitable for the business of the corporation, must be offered at public auction for sale once every year until sold, and that if any such corporation shall not within five years sell land so acquired at public or private sale, the State's attorney is required to proceed by information against the corporation in the circuit court, which court shall have jurisdiction to order the sale of such land or real estate. The last clause of § 26 of the act reads: "And no foreign or domestic corporation established or maintained in any way for the pecuniary profit of its stockholders or members, shall purchase or hold real estate in this State, except as provided for in this act."

It is not, and could not reasonably be, contended that under said general Incorporation Act a corporation can be organized for the purpose of purchasing and holding real estate. This act has often been before this court, and it has uniformly been held that acquiring and holding real estate are not purposes for which a corporation may be organized but that the organization of corporations for such purposes is forbidden by the statute. *Bixler* v. *Summerfield*, 195 Ill. 147; *People* v. *Pullman Palace Car Co.*, 175 id. 125; *Carroll* v. *City of East St. Louis*, 67 id. 568; *First M. E. Church* v. *Dixon*, 178 id. 260. Authority is given corporations organized for legitimate purposes, not prohibited by law, to acquire and hold such real estate as may be necessary for the transaction of the business of the corporation, but beyond this, corporations, no matter for what purpose organized, are forbidden to hold real estate, but are required by the

statute referred to, to sell the same within five years or be proceeded against by the State's attorney by information. That it has always been contrary to the public policy of this State to permit corporations to acquire and hold real estate was declared in *Carroll* v. *City of East St. Louis*, *supra*, where in an elaborate opinion the legislation, and the reasons for it, were pointed out.

It is next contended that if appellant's charter be held void it is not subject to be attacked collaterally, and that appellee having entered into a contract with appellant for the leasing of the premises is now estopped to deny its corporate existence. The general rule is, that where there is an attempt in good faith to organize under a law authorizing the incorporation, and corporate functions are exercised, this makes the organization a corporation *de facto*, and its legality cannot be questioned collaterally or by one who deals with it as a corporation. In such cases the introduction in evidence of the charter and proof of user, and that the party seeking to deny the legality of the corporation dealt with it as a corporation, sufficiently proves it a corporation *de facto*, and whether there may have been some irregularities in perfecting the incorporation will not be inquired into. The legality of such incorporation can only be attacked by the State in a direct proceeding. *Ramsey* v. *Peoria Marine and Fire Ins. Co.*, 55 Ill. 311; *Smith* v. *Mayfield*, 163 id. 447; *Mitchell* v. *Deeds*, 49 id. 416.

The appellee concedes that this is the rule as to *de facto* corporations but contends that there can only be a *de facto* corporation where there is a law under which the corporation might legally be organized, but that if there is no law authorizing the organization of such corporation its non-existence or invalidity may be set up collaterally. Cook on Corporations (§ 234) thus defines a corporation *de facto:* "The corporation is a *de facto* corporation where there is a law authorizing such a corporation and where the company has made an effort to organize under the law and is transacting business in a corporate name." In *American Trust Co.* v. *Minnesota and Northwestern Railroad Co.*, 157 Ill. 641, it was contended on behalf of certain corporations that had attempted a consolidation without any law authorizing such consolidation, that the validity of the consolidation, when not questioned by the State, must be sustained as against third persons and wrongdoers. The court held the rule of law was not as broad as contended for, and said (p. 652): "Where there is a *de facto* corporation, its corporate existence, except in a few exceptional cases, cannot be questioned collaterally, and can only be inquired into by the State and in a direct proceeding. *Hudson* v. *Green Hill Seminary*, 113 Ill. 618. But in order that there should be a *de facto* corporation two things are essential: First, there must be a law under which the corporation might lawfully be created; and second, user. Where the law authorizes a corporation, and there is an attempt, in good faith, to organize, and corporate functions are there-

upon exercised, there is a corporation *de facto*, the legal existence of which cannot ordinarily be questioned collaterally. This is not only the doctrine of *Judson* v. *Green Hill Seminary, supra*, but of numerous other decisions in this court. And in said *Hudson case* this court quoted with approval the language of the Supreme Court of Indiana in *Williamson* v. *Kokomo Building and Loan Ass.*, 89 Ind. 389, as follows: 'The rule stated does not go to the extent of precluding strangers from showing that there was no law authorizing a corporation.' In *Heaston* v. *Cincinnati, etc., Railroad Co.*, 16 Ind. 275, it is held that there must be a corporation *de facto* under an authority sanctioning such a corporation *de jure*. In *Eaton* v. *Walker*, 76 Mich. 579, it is said: 'But the two things necessary to show a corporation, even *de facto*, do not exist. There is no law under which the power they assume might lawfully be created, and the mere fact that they assumed to act as such, even in the full belief that they were legally incorporated, would not constitute them a corporation *de facto*.' See, also, *Swartwout* v. *Michigan Air Line Railroad Co.*, 24 Mich. 389; *Detroit Schuetzen Bund* v. *Detroit Agitations Verein*, 44 id. 313. In *Evenson* v. *Ellingson*, 67 Wis. 634, it is held that a body which cannot become a corporation *de jure* cannot become a corporation *de facto*. In *City of St. Louis* v. *Shields*, 62 Mo. 247, it is held that if a corporation be acting under legislative sanction and color of law its corporate character cannot be questioned collaterally. In *Pape* v. *Capitol Bank*, 20 Kan. 440, in discussing the matter of a *de facto* corporation, it is said by BREWER, J., that the charter of a corporation, with acts of user, is sufficient as against collateral inquiry; that the same principle obtains in respect to incorporations organized under a general law, but that there must in such cases be a law under which the incorporation can be had. And see, also, Cooley's Const. Lim. (6th ed.) p. 310." That to create a corporation *de facto* it is necessary that there be a law authorizing its incorporation, an attempt in good faith to comply with the law, and user, was decided in *Hudson* v. *Green Hill Seminary Co., supra*, *Marshall* v. *Keach*, 227 Ill. 35, and *Gillette* v. *Aurora Railways Co.*, 228 id. 261.

Appellant contends that the question of estoppel arising between parties by reason of a contract was not involved in *American Trust Co.* v. *Minnesota and Northwestern Railroad Co., supra*, and that it is not authority for the proposition that one dealing with a party as a corporation is estopped to deny its legal existence even though there is no law authorizing such incorporation. We do not understand the opinion to be capable of such distinction. In *Eaton* v. *Walker*, cited in the opinion, the Supreme Court of Michigan held that the pretended corporation itself might deny its legal existence, where there was no law authorizing its organization, when sued by a creditor with whom it had had dealings and to whom it had become indebted.

The rule that one dealing with a corporation is not estopped to deny its legal existence on the ground that there was no law authorizing it is based on the principle that the law will not recognize nor lend its aid to the organization as a *de facto* corporation where the law does not authorize or where it forbids such corporation. It is analogous to *ultra vires* acts and contracts of the corporation wholly beyond and outside the general scope of its corporate powers and entirely foreign to the objects and purposes of its creation.

We are not to be understood as holding appellee is not liable in any event for use and occupation of appellant's premises, for we are of the opinion if it occupied them under an agreement to pay rent, a liability was created which may be enforced in some appropriate proceeding, but it cannot be enforced in this suit.

We are of opinion the judgment of the circuit court was correct, and it is therefore affirmed.

Judgment affirmed.

NOTE. — See also *Clark* v. *American Co.*, 165 Ind. 213; *Raccoon River Co.* v. *Eagle*, 29 Ohio St. 238. Cf. *Homestead Co.* v. *Linigan*, 46 La. Ann. 1118.

WILDER MFG. CO. *v.* CORN PRODUCTS CO.

236 U.S. 165. 1915.

MR. CHIEF JUSTICE WHITE delivered the opinion of the court.

We refer to the parties, the one as the Manufacturing, and the other as the Refining Company. Sued by the Refining Company in April, 1909, to recover the amount of the price of two lots of glucose or corn syrup which it had bought in January, 1909, and which it had consumed and not paid for, the Manufacturing Company asserted its non-liability on the following grounds which we summarize:

(*a*) Because the Refining Company had no legal existence as it was a combination composed of all the manufacturers of glucose or corn syrup in the United States, illegally organized with the object of monopolizing all dealings in such products in violation of the Anti-Trust Act of Congress. That having illegally brought into one organization all the manufacturers of glucose or corn syrup, the corporation had unreasonably advanced the price of the products of its manufacture to the injury of the public. (*b*) That this end being accomplished, the corporation sought to perpetuate its monopoly by rendering it difficult or impossible for competitors to go into the business of producing glucose or corn syrup by devising a so-called profit-sharing scheme, by which it was proposed to give to all those who purchased from the combination a stipulated percentage upon the amount of the purchases made in one year to be paid at the end

of the following year provided that during such time they dealt with no one else but the combination. While the sum of the percentage thus offered, it was alleged, varied from year to year, nevertheless it was charged that in substance the contract or offer remained the same. The tender to the Manufacturing Company of a right to participate in the scheme, it was alleged, was first made in 1907 relative to the business done in 1906 in the form of a letter which is in the margin and this offer or asserted contract was continued from year to year. It was further alleged that the scheme proved successful in accomplishing its wrongful purpose since, although subsequently independent concerns engaged in the business of manufacturing glucose or corn syrup and offered to sell their products at prices less than those charged by the combination, such concerns were virtually driven out of business because those who desired to purchase the products were deterred from buying from them for fear of losing the percentage which they would receive from the combination if all their purchases continued to be made from it alone, and moreover because of the dread felt by purchasers that the independents would not be able to resist the overweening and controlling power of the combination. It was moreover alleged that all purchases made by the manufacturing company "contained the following clause in the contract of purchase: 'The goods herein sold are for your own consumption and not for resale.'"

Charging that the condition which made the payment of the proposed profit-sharing percentage depend upon dealing alone with the combination was void and should be disregarded, the answer asked not only that the prayer for judgment for the purchase price be rejected but that treating the failure of the Manufacturing Company to comply with the condition on which the offer of profit sharing was made as immaterial, there should be a judgment for that company for the percentage of profits on the business for the year 1908.

On motion the answer was stricken out as stating no defense. There was a judgment in the absence of further pleading against the Manufacturing Company for the price of the goods, as sued for, and rejecting its claim for the percentage of profits. This judgment was affirmed by the court below (11 Ga. App. 588) and because of an assumed failure to give effect to the Anti-Trust Act of Congress this writ of error was prosecuted.

As the context of the answer clearly justified the inference that the sale of the glucose was an interstate transaction, the court below was right in assuming that to be the case and therefore we put out of view as devoid of merit the contrary suggestion made by the Refining Company.

Having dealt with the Refining Company as an existing concern possessing the capacity to sell, speaking generally the assertion that it had no legal existence because it was an unlawful combination in

violation of the Anti-Trust Act was irrelevant to the question of the liability of the Manufacturing Company to pay for the goods since such defense was a mere collateral attack on the organization of the corporation which could not be lawfully made. Besides, considered from the point of view of the alleged illegality of the corporation, the attack on its existence was absolutely immaterial because the right to enforce the sale did not involve the question of combination, since conceding the illegal existence of the corporation making the sale, the obligation to pay the price was indubitable, and the duty to enforce it not disputable. This is true because the sale and the obligations which arose from it depended upon a distinct contract with reciprocal considerations moving between the parties, — the receipt of the goods on the one hand and the payment of the price on the other. And this is but a form of stating the elementary proposition that courts may not refuse to enforce an otherwise legal contract because of some indirect benefit to a wrongdoer which would be afforded from doing so or some remote aid to the accomplishment of a wrong which might possibly result — doctrines of such universal acceptance that no citation of authority is needed to demonstrate their existence, especially in view of the express ruling in *Connolly* v. *Union Sewer Pipe Co.*, 184 U.S. 540, applying them to the identical general question here involved.

The case therefore reduces itself to the question whether the contract of sale was inherently illegal so as to bring it within the also elementary rule that courts will not exert their powers to enforce illegal contracts or to compel wrongdoing. The only suggestion as to the intrinsic illegality of the sale results from the averments of the answer as to the offer of a percentage of profits upon the condition of dealing exclusively with the Refining Company for the following year and the clause to the effect that the goods were bought by the Manufacturing Company for its own use and not for resale. But we can see no ground whatever for holding that the contract of sale was illegal because of these conditions. In fact it is not so contended in argument since substantially the proposition which is relied upon is that although such stipulations were intrinsically legal, they become illegal as the result of the duty to consider them from the point of view that one of the parties was an illegal combination interested in inserting such conditions as an efficient means of sustaining its continued wrongdoing and therefore giving power to accomplish the baneful and prohibited results of its illegal organization, — a duty which, it is urged, results from reason, is commanded by the Anti-Trust Act and the obligation to enforce its provisions and is required because of a previous decision of this court enforcing that act (*Continental Wall Paper Co.* v. *Voight*, 212 U.S. 227) unless that decision is to be now qualified or overruled.

In the first place, the contention cannot be sustained consistently

with reason. It overthrows the general law. It admits the want of power to assail the existence of a corporate combination as a means of avoiding the duty to pay for goods bought from it and concedes at the same time the legality of the condition in the sale and yet proposes by bringing the two together to produce a new and strange result unsupported in any degree by the elements which are brought together to produce it and conflicting with both.

In the second place, the proposition is repugnant to the Anti-Trust Act. Beyond question reëxpressing what was ancient or existing and embodying that which it was deemed wise to newly enact, the Anti-Trust Act was intended in the most comprehensive way to provide against combinations or conspiracies in restraint of trade or commerce, the monopolization of trade or commerce or attempts to monopolize the same. *Standard Oil Co.* v. *United States*, 221 U.S. 1; *United States* v. *American Tobacco Co.*, 221 U.S. 106. In other words, founded upon broad conceptions of public policy, the prohibitions of the statute were enacted to prevent not the mere injury to an individual which would arise from the doing of the prohibited acts, but the harm to the general public which would be occasioned by the evils which it was contemplated would be prevented, and hence not only the prohibitions of the statute but the remedies which it provided were coextensive with such conceptions. Thus the statute expressly cast upon the Attorney-General of the United States the responsibility of enforcing its provisions, making it the duty of the district attorneys of the United States in their respective districts under his authority and direction to act concerning any violations of the law. And in addition, evidently contemplating that the official unity of initiative which was thus created to give effect to the statute required a like unity of judicial authority, the statute in express terms vested the Circuit Court of the United States with "jurisdiction to prevent and restrain violations of this act," and besides expressly conferred the amplest discretion in such courts to join such parties as might be deemed necessary and to exert such remedies as would fully accomplish the purposes intended. Act of July 2, 1890, chap. 647, 26 Stat. 209.

It is true that there are no words of express exclusion of the right of individuals to act in the enforcement of the statute or of courts generally to entertain complaints on that subject. But it is evident that such exclusion must be implied for a twofold reason: First, because of the familiar doctrine that "where a statute creates a new offense and denounces the penalty, or gives a new right and declares the remedy, the punishment or the remedy can be only that which the statute prescribes." *Farmers' & Mechanics' National Bank* v. *Dearing*, 91 U.S. 29, 35; *Barnet* v. *National Bank*, 98 U.S. 555; *Oates* v. *National Bank*, 100 U.S. 239; *Stephens* v. *Monongahela Bank*, 111 U.S. 197; *Tenn. Coal Co.* v. *George*, 233 U.S. 354, 359; Second, be-

cause of the destruction of the powers conferred by the statute and the frustration of the remedies which it creates which would obviously result from admitting the right of an individual as a means of defense to a suit brought against him on his individual and otherwise inherently legal contract to assert that the corporation or combination suing, had no legal existence in contemplation of the Anti-Trust Act. This is apparent since the power given by the statute to the Attorney-General is inconsistent with the existence of the right of an individual to independently act since the purpose of the statute was where a combination or organization was found to be illegally existing to put an end to such illegal existence for all purposes and thus protect the whole public, — an object incompatible with the thought that such a corporation should be treated as legally existing for the purpose of parting with its property by means of a contract of sale and yet be held to be civilly dead for the purpose of recovering the price of such sale and then by a failure to provide against its future exertion of power be recognized as virtually resurrected and in possession of authority to violate the law. And in a twofold sense these considerations so clearly demonstrate the conflict between the statute and the right now asserted under it as to render it unnecessary to pursue that subject further. In the first place because they show in addition how completely the right claimed would defeat the jurisdiction conferred by the statute on the courts of the United States, — a jurisdiction evidently given, as we have seen, for the purpose of making the relief to be afforded by a finding of illegal existence as broad as would be the necessities resulting from such finding. In the second place because the possibility of the wrong to be brought about by allowing the property to be obtained under a contract of sale without enforcing the duty to pay for it, not upon the ground of the illegality of the contract of sale but of the illegal organization of the seller, additionally points to the causes which may have operated to confine the right to question the legal existence of a corporation or combination to public authority sanctioned by the sense of public responsibility and not to leave it to individual action prompted it may be by purely selfish motives.

As from these considerations it results not only that there is no support afforded to the proposition that the Anti-Trust Act authorizes the direct or indirect suggestion of the illegal existence of a corporation as a means of defense to a suit brought by such corporation on an otherwise inherently legal and enforceable contract, but on the contrary that the provisions of the act add cogency to the principles of general law on the subject and therefore make more imperative the duty not directly or indirectly to permit such a defense to a suit to enforce such a contract, we put that subject out of view and come to the only remaining inquiry, the alleged effect of the previous ruling in the *Continental Wall Paper Case, supra.*

It is to be observed in considering that contention that the general rule of law which we have stated is not apparently questioned in the argument and the controlling influence of the ruling in the *Connolly Case, supra,* if here applicable is not denied, but the contention is that the general law is not applicable and the *Connolly Case* is inapposite because of an exception which was engrafted upon the general law by the ruling in the *Continental Wall Paper Case* under which it is said this case comes. While it clearly appears that this is the contention, it is difficult to precisely fix the ground upon which it is rested. But as the rule of general law which under ordinary circumstances does not permit the existence of a corporation to be indirectly attacked is not assailed, and as it is not asserted that irrespective of the illegal organization of the corporation, the contract of sale was inherently unlawful, it follows that the proposition is the one which we have already in another aspect disposed of, that is, that the sale and its conditions although inherently legal become illegal by considering the illegal corporation and the aid to be afforded to its wrongful purposes by the conditions which formed a part of the sale. But in substance this only assumes that it was held in the *Continental Wall Paper Case* that that which was inherently legal can be rendered illegal by considering in connection with it something which there is no right to consider at all. But it is apparent on the face of the opinion in the *Continental Wall Paper Case* that it affords no ground for the extreme and contradictory conclusion thus deduced from it since the ruling in that case was based not upon any supposed right to import into a legal and valid contract elements of wrong which there was no right to consider, but was rested exclusively upon elements of illegality inhering in the particular contract of sale in that case which elements of illegality may be thus summarized: (*a*) the relations of the contracting parties to the goods sold, (*b*) the want of real ownerslip in the seller, (*c*) the peculiar obligations which were imposed upon the buyer, and (*d*) the fact that to allow the nominal seller to enforce the payment of the price would have been in and of itself directly to sanction and give effect to a violation of the Anti-Trust Act inhering in the sale. It is not necessary to analyze the facts and issues in the case for the purpose of pointing out how completely they are covered by the statement just made because the opinion of the court and the reasons stated by the members of the court who dissented without more make that fact perfectly clear. Indeed not only does this statement make clear the fact that there is no conflict between the *Connolly Case* and the *Continental Wall Paper Case*, but it also establishes that both cases, the first directly, and the other by a negative pregnant, demonstrate the want of merit in the contentions here insisted upon.

It only remains to say that we think it requires nothing but statement to demonstrate that in view of the facts which we have recited

and the legal principles which we have applied to them, no error was committed by the court below in refusing to give to the defendant a judgment for its alleged share of the profits for the year 1908 when it was expressly admitted that the conditions upon which the offer of a right to a participation in the profits was rested, or the contract (if there was a contract to that effect) was based, had not been complied with.

Affirmed.

NOTE. — Where incorporation failed because of a lack of good faith on the part of the associates, but this lack in no wise injured A, there may be a recovery in the name of the alleged corporation for breach of A's contract. See *Southern Bank* v. *Williams*, 25 Ga. 534; *Smith* v. *Mississippi Co.*, 14 Miss. 179; *United States Co.* v. *Schlegel*, 143 N.Y. 537; *Wallace* v. *Loomis*, 97 U.S. 146, 154.

DAVIS *v.* STEVENS.

104 Fed. 235. 1900.

IN the U.S. District Court for the District of South Dakota.

On March 21, 1900, creditors of the Bank of Plankinton filed a petition, praying that the Bank of Plankinton be adjudged bankrupt, as a private banking institution, and a co-partnership consisting of the above-named defendants. In their answer defendants deny generally the allegations of the petition, and, further answering, allege that the Bank of Plankinton was during the times alleged in the petition, and now is, a corporation duly organized under the laws of the territory of Dakota and the state of South Dakota. It appears from the testimony and admission of the parties to this proceeding that on the 27th day of November, 1885, articles of incorporation, duly signed and acknowledged by Edwin S. Rowley, Fred L. Stevens, Charles A. Johnson, Joseph D. McCormick, and William M. Smith, were duly filed in the office of the secretary of the territory of Dakota, wherein it was stated that the business of the proposed corporation, which was to be called the Bank of Plankinton, should be a general banking, real estate, and loan business. Upon the filing of said articles there was issued by the secretary of the territory of Dakota a certificate of corporate existence to the parties above named, wherein it was certified that said parties, their associates and successors, had become a body politic and corporate under the corporate name of Bank of Plankinton. It further appears that the Bank of Plankinton did business as a banking corporation from the time of its alleged incorporation until about Jan. 10, 1900, when it closed its doors and ceased to do business.

CARLAND, District Judge. [After stating the case.] It is claimed

by the petitioners that, as there was no law of the territory of Dakota which authorized the incorporation of individuals to do a banking business, the defendants in this proceeding, who are alleged to have owned stock in this corporation, were simply partners, and as such were doing business as a private bank, and thus subject to be adjudicated a bankrupt as a private bank. It is contended by the defendants that whether or not the Bank of Plankinton was a corporation cannot be inquired into collaterally, and that the state of South Dakota is the only power which could, by proceedings in the nature of a *quo warranto*, inquire into the legal organization of this corporation. If the Bank of Plankinton was a *de facto* corporation, this position would be unassailable. But, in order that there may be a *de facto* corporation, it must have been possible for the territory of Dakota to have chartered a *de jure* corporation, and as there was no law of the territory of Dakota permitting the incorporation of banking corporations at the time the Bank of Plankinton received its certificate of corporate existence, it results that there cannot be a *de facto* corporation. The limitation of the doctrine that the validity of corporate existence cannot be litigated collaterally is that, where there is no law under which a corporation might exist, then the validity of corporate existence may be attacked collaterally. *Heaston* v. *Railroad Co.*, 16 Ind. 275; *Krutz* v. *Town Co.*, 20 Kan. 397; *Eaton* v. *Walker*, 76 Mich. 579, 43 N.W. 638, 6 L.R.A. 102; 1 Thomp. Corp. § 505. As is said in § 502, 1 Thomp. Corp.: —

"We must not get too far away from the primal proposition that the legislature alone can create a corporation, and that a collection of individuals cannot make themselves a corporation by merely resolving to be such, or calling themselves such. The three tailors of Tooley street did not make themselves the people of England by passing a resolution in which they styled themselves such. There must be some basis for the operation of the rule, and accordingly we find a better statement of it in the proposition that where a corporation exists *de facto*, and in fact exercises corporate powers, the question whether it exercises such powers lawfully cannot be litigated in a collateral proceeding between private parties, or between a private party and the corporation. The question can only be litigated between the corporation and the state."

Defendants invoke § 2892 of the Compiled Laws of Dakota, which is in the following language: —

"The due incorporation of any company claiming in good faith to be a corporation under this chapter and doing business as such, or its right to exercise corporate powers, shall not be inquired into collaterally in any private suit to which such *de facto* corporation may be a party, but such inquiry may be had and action brought at the suit of the territory in the manner prescribed in the Code of Civil Procedure."

This section, as I understand it, simply declares the law in the same manner that the courts declare it. It presupposes that there is a *de facto* corporation, which cannot exist if there could have existed no *de jure* corporation. In the case of *Oroville & V. R. Co.* v. *Supervisors of Plumas Co.*, 37 Cal. 354, it was held by the Supreme Court of California that a similar provision in the laws of that State did not go to the extent of precluding private persons from denying the existence *de jure* or *de facto* of the alleged corporation. . . .

As the claims of the creditors who are petitioners in this action arise from simply depositing money with the Bank of Plankinton, there is no such relation between the bank and the creditors as would allow the principle of estoppel to be urged. I, therefore, am of the opinion that the parties interested in the Bank of Plankinton were co-partners.

[Petition dismissed for other reasons.]

NOTE. — To the same effect are *Booth* v. *Wonderly*, 36 N.J.L. 250 (a charter authorizing a business to be carried on in Trenton was used in conducting a business at Jersey City; apparently no stock was subscribed; the persons who assumed to act as directors were held to full liability); *Ridenour* v. *Mayo*, 40 Ohio St. 9 (trustees of a savings bank used name of bank in carrying on a general banking business). See also *Vredenburg* v. *Behan*, 33 La. Ann. 627; *Hill* v. *Beach*, 1 Beasl. (N.J.) 31, 36 (one ground of the decision was that the laws of New York did not authorize a corporation to be formed by the residents of another state to do business only in that other State).

In *Merchants' Bank* v. *Stone*, 38 Mich. 779, MARSTON, J., dissenting, *held*, that a statute authorizing manufacturing corporations did not authorize lumbering companies, and that the associates were exposed to full liability. The grounds on which the majority proceeded, in protecting the associates, are not clear.

If the law under which the associates organized is unconstitutional, the court, in *Michigan* v. *How*, 1 Mich. 512, said that the associates would be exposed to full liability. "When the law under which such exemption is claimed is unconstitutional, the exemption itself ceases to exist." There is a dictum to the same effect in *Burton* v. *Schildbach*, 45 Mich. 504, 511, and a decision in *Eaton* v. *Walker*, 76 Mich. 579, 590. "Obligors are bound, not by the style which they give to themselves, but by the consequences which they incur by reason of their acts." The court would apparently have held the associates even if the plaintiff had admitted that he dealt with them as a corporation. See also *Clark* v. *American Co.*, 165 Ind. 213, 216; *Chenango Bridge Co.* v. *Paige*, 83 N.Y. 178, 190.

In *Planters' Bank* v. *Padgett*, 69 Ga. 159, a court assumed, by a judgment, to incorporate associates. The judgment was held to be

void, but the associates were shielded from full liability on the authority of Morawetz, § 748.

In *Richards* v. *Minnesota Bank*, 75 Minn. 196, the name of a corporation *de jure* was changed. *Held*, that, even if the act making the change was unconstitutional, persons contracting with the corporation in such new name could not hold the stockholders to full liability.

PROVIDENT BANK & TRUST CO. *v.* SAXON.

116 La. 408. 1906.

LAND, J. Plaintiff's suit was dismissed on an exception of no cause of action, which necessarily admits all the facts alleged in the petition.

The defendants were sued as members of a commercial partnership, formerly doing business in the city of New Orleans under the name of the "Vossburg Mineral Springs Co., Ltd."

It is alleged that the business of the concern was the selling of spring water in bottles, packages, or otherwise, and that the company became indebted to plaintiff on deposit account in the sum of $6,899.73, or in the alternative in the same sum on a note and a number of drafts filed and made part of the petition.

The deposit account was kept in the name of the "Vossburg Mineral Springs Co., Ltd." The note is signed in the same name by "Henry Mordecai, President," and the drafts were drawn by him officially to the order of, and indorsed by, the "Vossburg Mineral Springs Co., Ltd."

In eight instances shares of stock of said company were attached to drafts as collateral. The note and all of the drafts were discounted by the plaintiff bank, and the net proceeds placed at credit of the company.

The petition alleges that the defendant and others, constituting the company, so called, falsely claimed to be and have been a corporation established under the laws of this state, whereas it was in truth and to the knowledge of defendants a commercial partnership only.

The petition charges that the pretense that the Vossburg Mineral Spring Co., Ltd., was a corporation was nugatory for the reason, among others, "that no original or other subscriptions made for the purpose of organizing the said company or any list of subscriptions was recorded in the office of the recorder of mortgages for this parish," as is required by § 686 of the Revised Statutes of 1870; that the charter was not published in a newspaper or daily journal as enjoined by the same section, but in a weekly religious journal with a limited circulation confined to the members of a certain church

organization; that the company never had a true capital subscribed of $5,000, as required by law; that the pretended charter does not affix any manner or terms of payment of its alleged stock as enjoined by Rev. St. 1870, § 685; that there never was any real subscription to stock of the said corporation, or any intention by the parties forming the same to so subscribe; that there were never any payments for such stock either made or intended by the parties concerned.

The charter was not annexed to the petition, and its contents can be ascertained only by reference to the allegations of the pleader.

Several defects "among others" are pointed out, but there is no presumption that the charter was perfect in all other respects, or that all other formalities required by law were observed.

The pleader, after alleging facts sufficient to charge defendants as commercial partners, seems to have anticipated the probable defense that defendants were not members of a commercial partnership, but were stockholders in a *de jure* or *de facto* corporation, and therefore not liable personally for the claims sued on.

It is not alleged in the petition that the charter was recorded in the office of the recorder of mortgages. The whole argument for the defense is based on the proposition that defendants undertook to form a corporation under the existing laws of this State; that they had executed, recorded in the mortgage office, and published their charter; that the corporation so formed had subsequently done business as a corporation; and that it had been recognized as a valid corporation, and all of its acts and contracts ratified by Act No. 120, p. 281, of 1904.[1]

We assume that the act was passed for the benefit of persons who had actually and in good faith attempted to organize corporations for business purposes, but, in so doing, had committed errors and mistakes in the proceedings or in the instruments of incorporation.

The petition charges that the so-called corporation was a commercial partnership doing business in the name of a limited liability company, and that defendant falsely and knowingly pretended that the partnership was a corporation established under the laws of the State.

It is charged that there was never any real subscription to the capital stock or any intention by the parties forming the company to so subscribe, and that there never were payments for such stock either made or intended to be made by the parties concerned.

[1] This act provided "that whenever persons have undertaken to form a corporation under any of the existing laws of this State, and have executed, recorded in the mortgage office, and published their charters, the corporations so formed and subsequently doing business as corporations, are hereby recognized and declared to be now and hereafter, for the term stated in their charters, valid corporations, notwithstanding that the charters may have authorized the carrying on by one corporation of several branches of business, the carrying on of which by corporations is authorized by different statutes of this State, and notwithstanding irregularities in the proceedings and instruments of the incorporation."

Admitting all the allegations of the petition to be true, it follows that the corporation, so called, was but a name, under which the defendants conducted a commercial business.

The allegations of the petition are sufficient to show a cause of action against the defendants as commercial partners, and do not disclose that the "Vossburg Springs Company, Ltd.," was a corporation *de jure* or *de facto* under the laws of this State.

The pleader might have well rested on his allegation that the defendants were commercial partners, without anticipating the defense. The questions of law raised are of the utmost importance, but find no application to such a corporation as that described in the petition, consisting of a name and nothing more.

This court has decided in a number of cases that the fact that a creditor has contracted with a company holding itself out as a corporation does not necessarily work an estoppel to deny its legal corporate existence. *Spencer Field & Co.* v. *Cooks et al.*, 16 La. Ann. 153; *Chaffe* v. *Ludeling et al.*, 27 La. Ann. 611; *Williams* v. *Hewitt*, 47 La. Ann. 1076, 17 South. 196, 49 Am. St. Rep. 394; *Lehman* v. *Knapp et al.*, 48 La. Ann. 1154, 20 South. 674.

It is therefore ordered and decreed that the judgment appealed from be reversed, and it is now ordered and decreed that the exceptions of no cause of action be overruled, and that this cause be remanded for further proceedings according to law; costs of appeal to be paid by appellees.

NOTE. — Where the associates have not, in assuming to incorporate, acted in good faith, a preliminary question arises. It seems always to have been the law in this country that a charter obtained by fraud was voidable, and not void (as to the English law, see *Morgan* v. *Seaward*, 2 M. &. W. 544, 561; *Macbride* v. *Lindsay*, 9 Hare, 574, 583; *Robinson* v. *London Hospital*, 22 L.J. Ch. 754, 757). Thus, if the legislature is induced by fraud to pass a special act of incorporation, the corporation comes into being, and the fraud is only a cause of forfeiture by the state. *Charles River Bridge* v. *Warren Bridge*, 7 Pick. (Mass.) 344, 370. Similarly, if the legislature has by a special or general law authorized a designated official or body to issue a charter or a certificate (which is made conclusive evidence of incorporation) upon the performance of conditions precedent, and the official or body is induced by fraud to issue such charter or certificate. *Rice* v. *Bank of Commonwealth*, 126 Mass. 300 (Mass. Laws of 1903, chap. 437, § 12, provides that the certificate of the Secretary of State "shall have the force and effect of a special charter"); *Nat'l Bank* v. *Rockefeller*, 195 Mo. 15, 42 (the statute provides that the certificate of the Secretary of State "shall be taken by all courts of this State as evidence of the corporate existence of such corporation"; the court held that the certificate was equivalent to a special

act of the legislature; whether this was a sound construction of the statute, *quaere*); *Centre Co.* v. *M'Conaby*, 16 Serg. & R. (Pa.) 140, 1 Pen. & W. (Pa.) 426, 431; *Travaglini* v. *Societa Italiane*, 5 Pa. Dist. 441; *German Ins. Co.* v. *Strahl*, 13 Phila. (Pa.) 512. See also *Pattison* v. *Albany Ass'n*, 63 Ga. 373; *Laflin Co.* v. *Sinsheimer*, 46 Md. 315; *U.S. Vinegar Co.* v. *Schlegel*, 143 N.Y. 537; *Cochran* v. *Arnold*, 58 Pa. St. 399; *Wells Co.* v. *Gastonia Co.*, 198 U.S. 177, 185. Similarly, if the designated official or body is induced by fraud to do an act the performance of which is one of the conditions precedent to incorporation. *Duke* v. *Cahawba Co.*, 16 Ala. 372; *Litchfield Bank* v. *Church*, 29 Conn. 137, 148; *Jones* v. *Dana*, 24 Barb. (N.Y.) 395; *Tar River Co.* v. *Neal*, 3 Hawks (N.C.) 520.

Wherever the legislature has authorized the formation of a corporation upon the performance of certain conditions precedent, the courts must necessarily determine whether the legislature intended to require a certain mental state in the corporators as one of these conditions. Considering the difficulty of proof on such a point, the courts may incline against such a construction of the law. See *Importing Co.* v. *Locke*, 50 Ala. 332, 334; *Niemeyer* v. *Little Rock Ry.*, 43 Ark. 111, 120; *Aurora Co.* v. *Lawrenceburgh*, 56 Ind. 80, 87; *Lincoln Ass'n* v. *Graham*, 7 Neb. 173; *Atty.-Gen.* v. *Stevens*, Saxt. Ch. (N.J.) 369, 378; *Nat'l Docks Co.* v. *Central R.R.*, 32 N.J. Eq. 755; *Terhune* v. *Midland Co.*, 38 N.J. Eq. 423; *Atty.-Gen.* v. *Am. Tobacco Co.*, 55 N.J. Eq. 352, 369, aff'd, 56 N.J. Eq. 847; *Buffalo Co.* v. *Hatch*, 20 N.Y. 157, 159; *Wellington Co.* v. *Cashie Co.*, 114 N.C. 690; *Cochran* v. *Arnold*, 58 Pa. St. 399, 405; *Windsor Co.* v. *Carnegie Co.*, 204 Pa. St. 459, and cases cited. *Cf. Christian Co.* v. *Fruitdale Co.*, 121 Ala. 340, 345; *Montgomery* v. *Forbes*, 148 Mass. 249; *Augir* v. *Ryan*, 63 Minn. 373; *Hill* v. *Beach*, 1 Beasl. (N.J.) 31, 36; *Jersey City Co.* v. *Dwight*, 29 N.J. Eq. 242 (the learned vice-chancellor who decided this case assumed, 46 N.J. Eq. 130, that it could not stand with 32 N.J. Eq. 755. But see 49 N.J. Eq. 329, 335); *Elizabeth Co.* v. *Green*, 49 N.J. Eq. 329 (by five dissenting judges. Whether the majority was opposed on this point does not appear. The decision is explained in 52 N.J. Eq. 111, 144, on a ground consistent with this opinion by the dissenting judges); *Farnham* v. *Benedict*, 107 N.Y. 159, 169; *Brundred* v. *Rice*, 49 Ohio St. 640; *McGrew* v. *City Produce Exchange*, 85 Tenn. 572; *Le Warne* v. *Meyer*, 38 Fed. 191. See also *Carey* v. *Cincinnati Co.*, 5 Ia. 357; *Chicora Co.* v. *Crews*, 6 S.C. 243, 275. In *New Orleans Co.* v. *Louisiana*, 180 U.S. 320, 330, PECKHAM, J., said: "If not created for a lawful purpose, the company was not created at all." There is a dictum to the same effect by Lord HERSCHELL in *Salomon* v. *Broderip*, [1897] A.C. 22, 43.

The legislature may, however, require a certain mental state as a condition precedent to incorporation. Thus it may require that certain subscriptions or payments be made in good faith. And, it is

submitted, where the legislature requires that certain statements be made and filed or recorded in a public office, the courts should hold that the legislature intended to require that such statements be made in good faith.

Assume that such requirement is made. For example, the legislature requires the associates to state the amount of capital stock subscribed and paid in. The associates make statements which are false, and which are known to be false. If incorporation fails because such statements are not made in good faith, it would seem to be clear that the associates should be held to full liability on their contracts. To say that A, the other contracting party, is estopped to show that the associates are not incorporated when the incorporation has failed because the associates made a representation which they knew was not true, and A has acted on it to his hurt, would be contrary to the principles underlying the law of estoppel. There is no equity in estopping A under these circumstances; the equity is all the other way. Here then is a case where justice between the parties and public policy both require that the associates be held to full liability. One may be permitted to be astonished at a doctrine which protects the associates, — it is contrary to the manner in which the courts deal with fraud in every other branch of the law.

In *Gow* v. *Collin Co.*, 109 Mich. 45, the plaintiff alleged that the statements of the associates in their certificate of incorporation respecting their capital were false, and that he contracted with them relying on these statements; he sought to hold them to full liability. A demurrer to the bill was sustained. "The company, in form, was duly incorporated, was recognized by the public authorities, and filed its annual reports, and did business as a corporation. The complainants dealt with it as a corporation." In substance, this was all the consideration which the court gave to the point. The decision is the more remarkable when compared with *Doyle* v. *Mizner*, 42 Mich. 332.

In *Cochran* v. *Arnold*, 58 Pa. St. 399, the reasoning of the court goes as far as the decision in *Gow* v. *Collin Co.* But the statements, although technically untrue, do not seem to have been made in bad faith, and, in any event, the other contracting party knew all the facts.

Laflin Co. v. *Sinsheimer*, 46 Md. 315. From portions of the opinion it would appear that the court dealt with the case as one of incorporation secured by fraud. But elsewhere (p. 320) it says that the validity of the incorporation cannot be collaterally attacked "by proving *aliunde* the certificate of its incorporation that certain prerequisites of the law had not been in good faith complied with."

In *Webb* v. *Rockefeller*, 195 Mo. 57, the court held that A, who had contracted with the associates as a corporation, could not recover in tort from them because he was not of the class intended to be influenced by the representations as to their capital.

On the other hand, there are the following authorities in support of the principal case. In *Montgomery* v. *Forbes*, 148 Mass. 249, the defendant falsely stated that the business of the corporation was to be carried on in a certain State; he thereafter purchased goods in the name of the corporation, and was held to full liability. There is a dictum to the same effect in *Gartside Co.* v. *Maxwell*, 22 Fed. 197. See also *Cleaton* v. *Emery*, 49 Mo. App. 345; *Davidson* v. *Hobson*, 59 Mo. App. 130; *Hill* v. *Beach*, 1 Beasl. (N.J.) 31, 36; *Booth* v. *Wonderly*, 36 N.J.L. 250.

In *Brundred* v. *Rice*, 49 Ohio St. 640, 650, where a corporation was not organized in good faith, but for the purpose of consummating an illegal agreement, the associates were held accountable for moneys nominally paid to the corporation. "The act of incorporating can be of no avail to them as a defense." To the same effect is *McGrew* v. *City Produce Exchange*, 85 Tenn. 572.

If the attempt at incorporation is not made in good faith, but persons purchase the stock in good faith, they should not be exposed to full liability to those who have contracted with the corporation. *American Co.* v. *Heidenheimer*, 80 Tex. 344. See also *Minor* v. *Mechanics Bank*, 1 Pet. (U.S.) 46, 66.

COTTENTIN *v.* MEYER.

80 N.J.L. 52. 1910.

The plaintiff sought to recover against certain individuals for breach of a contract in which the named obligor was the Cottentin Hotel Co.

Swayze, J. We think the evidence justified the submission to the jury of the question whether the Cottentin Hotel Company was organized as a corporation at the time the plaintiff made the contract upon which his suit was brought. If, in fact, the certificate was not signed until August, there was no *de facto* corporation in the preceding April and the case is not controlled by the rule of *Hackensack Water Co.* v. *De Kay*, 9 Stew. Eq. 548, 559; *Stout* v. *Zulick*, 19 Vroom, 599, and *Vanneman* v. *Young*, 23 Id. 403. Nor does it come within the rule of *Den* v. *Van Houten*, 5 Halst. 270, and the numerous cases in other jurisdictions where a similar situation was presented. Those cases rest upon the doctrine of estoppel. In *Den.* v. *Van Houten* the mortgagor, by giving a mortgage in form to a corporation, represented in effect to the assignee of the mortgage that the original mortgagee was in fact a corporation.

In *Close* v. *Glenwood Cemetery*, 107 U.S. 466, Close, by making deeds in the name of the corporation for cemetery plots, represented that there was an actual corporation capable of owning and conveying the lots. There are cases which go further and hold that one who

deals as with a corporation and thereby obtains a benefit, cannot afterwards, when sued in the corporate name, deny the actual existence of the corporation. It is as Mr. Machen, in his recent book on Corporations, points out (§ 282), difficult to see how the principle of estoppel is applicable to such a case, since it can hardly be supposed that those who act as a corporation without even a colorable organization, can be misled into a belief that they are actually incorporated by the representation of an outsider who is without their means of knowledge. Even those cases, however, fall short of the present. If, in fact, Meyer and McKenna were merely using the corporate name in which to make their own contracts, they were in no way misled by the act of Cottentin in entering into a written contract which expressly described the Cottentin Hotel Company as a New Jersey corporation. On the contrary it was they who in that event misled Cottentin by purporting to contract as a corporation and they cannot escape liability if, in fact, Cottentin Hotel Company was merely their trade name. This, under the evidence, was a jury question.

NOTE. — The assumption of the corporate privilege may, it is submitted, be called naked wherever the associates have not filed or recorded or published their certificate of incorporation (or similar paper) in at least one of the ways provided by law.

Where the assumption of the corporate privilege was naked, the associates have uniformly been held to full liability to the other contracting party. *Forbes* v. *Whittemore*, 62 Ark. 229; *Pettis* v. *Atkins*, 60 Ill. 454; *Chaffe* v. *Ludeling*, 27 La. Ann. 607, 611; *Johnson* v. *Corser*, 34 Minn. 355 (see the explanation of this case in 52 Minn. 239, 244); *Furniture Co.* v. *Crawford*, 127 Mo. 356, 364; *Abbott* v. *Omaha Smelting Co.*, 4 Neb. 416; *McVicker* v. *Cone*, 21 Or. 353; *Haslett* v. *Wotherspoon*, 2 Rich. Eq. (S.C.) 395.

See also *Brooke* v. *Day*, 129 Ga. 694 (no colorable requirements with terms of charter); *Bank* v. *Sheldon*, 86 Kan. 460.

In *Bank of Watertown* v. *Landon*, 45 N.Y. 410, the associates, after the expiration of their charter, agreed to continue the business, and the business was continued ostensibly by a corporation. The plaintiff became the owner of a note signed in the name of the corporation, and which he believed was made by a corporation *de jure*. The associates were held to full liability. *Cf.* the dictum in *Miller* v. *Coal Co.*, 31 W.Va. 836, 840.

NOTE.

ON the liability of the agent of a corporation, by assumption, to the other contracting party see *Coleman* v. *Coleman*, 78 Ind. 344, 346; *Hurt* v. *Salisbury*, 55 Mo. 310; *Lagrone* v. *Timmerman*, 46 S.C. 372.

SECTION 2.

WHERE THERE HAVE BEEN NO DEALINGS BETWEEN THE PARTIES ON A CORPORATE BASIS.

SOCIETY PERUN *v.* CLEVELAND.

43 Ohio 481. 1885.

ACTION by city of Cleveland to foreclose a mortgage, as against certain subsequent grantees, mortgagees, and purchasers. Perun, a corporation, January 28, 1874, executed and delivered a mortgage to the city. This mortgage was not filed for record until October 21, 1879. In February, 1874, certain persons attempted to organize, under general laws, a corporation by the name of Society Perun. In May, 1874, Perun delivered to Society Perun its deed, purporting to convey to the latter the premises theretofore mortgaged to the city. Between that date and October 21, 1879, Society Perun, acting in its supposed corporate capacity, executed and delivered deeds and mortgages, purporting to convey and incumber parcels of these mortgaged premises to various parties, who are made defendants in the present suit. During the pendency of the present foreclosure suit, it was adjudged, in a *quo warranto* proceeding, instituted by the Attorney-General, that the persons who attempted to incorporate under the name of Society Perun had not been legally incorporated, and that their attempted organization as a corporation was wholly void; and a decree of ouster was rendered. Upon the trial of the present foreclosure suit in the District Court, the plaintiff gave in evidence, against the objection of the defendants, the record of the *quo warranto* proceedings. Defendants offered evidence tending to prove an attempt in good faith to incorporate Society Perun. This evidence was excluded, and defendants excepted. The District Court found, among other things, that, as to the city of Cleveland, Society Perun was not a corporation either in law or in fact; that the conveyance to it by Perun was void as against the city; and that the claims of all the defendants (except certain claims for taxes and improvements) were subsequent and inferior to the lien of the city. To reverse the judgment rendered upon these findings, error was brought.

OWEN, J. The defendants below, conceding that Society Perun had never been a corporation *de jure*, maintain that the court below should have permitted them to prove that such society was a *de facto* corporation; that it attempted, in good faith, to become a body

corporate; proceeded to act and transact business in good faith under the supposed authority of incorporation, and that its acts ought not to have been declared to be wholly void as against the city of Cleveland.

The judgment of ouster was an adjudication between the State and the society upon the right of the latter to exercise corporate franchises. For the purposes of such adjudication it was competent for this court to consider and determine what had been its *status* from its first attempt to incorporate. But it had no power to pass upon or determine the rights of parties not before it.

It was not competent for this court to determine in that proceeding that Society Perun had never been a corporation *de facto*, or that its acts and business transactions, under the color of its supposed charter powers, were void. The authority of the court in that behalf was derived from § 6774 (Rev. Stats.), which provides: "When a defendant is found guilty of usurping, intruding into, or unlawfully holding or exercising an office, franchise, or privilege, judgment shall be rendered that such defendant be ousted and altogether excluded therefrom, and that the relator recover his costs."

When the court had excluded the society from its franchises to be a corporation, it exhausted its jurisdiction over the subject-matter. It had no power to speak concerning whatever rights may have been acquired by the society as a corporation *de facto*, or by third parties in their transactions with it as an acting corporation.

It is conceded by the city that parties who had recognized the existence of the society by their transactions with it as a supposed corporation are estopped to deny its corporate existence. But it is maintained that the city, having engaged in no transactions with it, is free to challenge its existence as a corporation *de facto* as well as *de jure*. The argument is that: "No case can be found where it is held that there is a corporation *de facto* against persons who have in no way recognized its existence as a corporation," and that: "The notion of a *de facto* corporation is based on the doctrine of estoppel; when estoppel can not be invoked there can be no *de facto* corporation."

The theory that a *de facto* corporation has no real existence, that it is a mere phantom, to be invoked only by that rule of estoppel which forbids a party who has dealt with a pretended corporation to deny its corporate existence, has no foundation, either in reason or authority. A *de facto* corporation is a reality. It has an actual and substantial legal existence. It is, as the term implies, *a corporation.*

"It is a self-evident proposition that a contract can not be made with a corporation unless the corporation be in existence at the time. A real contract with an imaginary corporation is as impossible, in the nature of things, as a real contract with an imaginary person. It is essential, therefore, in order to establish the existence of a contract

with a corporation, to show that the corporation was in existence, at least *de facto*, at the time the contract was made." Morawetz Private Corporations, § 137.

It is bound by all such acts as it might rightfully perform as a corporation *de jure*. Where it has attempted in good faith to assume corporate powers; where its proceedings in that behalf are colorable, and are approved by those officers of the state who are authorized to act in that regard; where it has honestly proceeded for a number of years, without interference from the State, to transact business as a corporation; has been reputed and dealt with as a duly incorporated body, and valuable rights and interests have been acquired and transferred by it, no substantial reason is suggested why its corporate existence, in a suit involving such transactions, should be subject to attack by any other party than the State, and then only when it is called upon in a direct proceeding for that purpose, to show by what authority it assumes to be a corporation.

Proof was offered upon the trial below to show, (1) that the persons seeking to incorporate first filed with the Secretary of State a certificate which fully complied with the requirements of the statutes, and free from the defect which finally proved fatal to its existence, but which was disapproved by the Attorney-General; (2) that the certificate of incorporation which was finally filed with the Secretary of State recited that, "said association has been formed and organized for the mutual protection and relief of its members, and for the payment of stipulated sums of money to the families or heirs of the deceased members of said association; that the officers of said association have been duly chosen; that for the purpose of becoming a body corporate under an act passed by the general assembly of the State of Ohio, entitled, an act supplementary to an act, entitled an act to provide for the creation and regulation of incorporated companies in the State of Ohio, passed May 1, 1852, passed April 20, 1872"; (3) that this certificate was approved by the Secretary of State, and also by the Attorney-General, as provided by the statutes (69 Ohio L. 150); (4) that it proceeded in good faith to transact business peculiar to corporations provided for by the act under which it attempted to incorporate.

All this was excluded, and the decision of the court below practically rested on the proof offered by the city, that Society Perun had been ousted of its franchises, which was evidently construed as determining that such society had from the first no corporate existence, either *de jure* or *de facto*, and consequently no capacity to receive or impart any interest in or title to real estate except as against such parties as were by reason of their recognition of or dealings with it, estopped to deny its incorporate existence.

Did the court err? This fairly presents the controlling and very important question: Was it competent to show, as against a party

who was not estopped to deny its corporate existence, that Society Perun was, at the time of the transactions involved in controversy, a corporation *de facto?*

In *Attorney-General ex rel. Pettee* v. *Stevens*, Saxton (N.J. Eq.) 369, the relator sought to enjoin the Camden and Amboy Railroad and Transportation Company and others acting under its authority from erecting a bridge over a navigable stream. The claim was that the act authorizing the corporation had been perverted and disregarded, and that there was no legal incorporation. The relators were in no manner estopped to attack the corporate existence of the respondent. The court held: —

"Where a set of men claiming to be a legally incorporated company under an act of the legislature, have done everything necessary to constitute them a corporation, colorably at least, if not legally, and are exercising all the powers and functions of a corporation; they are a corporation, *de facto,* if not *de jure;* and this court will not interfere, in an incidental way, to declare all their proceedings void, and treat them as a body having no rights of powers."

The chancellor, speaking for the court, said: —

"Here, then, is a set of men claiming to be a legally incorporated company under the act of the legislature, exercising all the powers and functions of a corporation. They are a corporation *de facto*, if not *de jure.* Every thing necessary to constitute them a corporation has been done, colorably at least, if not legally; and I do not feel at liberty, in this incidental way, to declare all their proceedings void, and treat them as a body having no rights or powers. It has been seen that the court will not do this where a corporation properly organized has plainly forfeited its privileges; and there is but little difference in principle between the two cases. In both the corporation is actually in existence, but whether legally and rightfully so is the question. And it appears to me that if the court can take cognizance of the matter in this case, it must in all others where it can be brought up, not only directly, but incidentally."

This case is approved and followed in *National Docks R. Co.* v. *Central R.R. Co.*, 32 N.J. Eq. 755, which held: "When a corporation exists *de facto*, the court of chancery can not, at the instance of private parties, restrain its operations upon the ground that its organization is not *de jure.* In such case the proper remedy is by *quo warranto*, or information in the nature thereof, instituted by the Attorney-General." The rule of estoppel found no place in this case.

In *S. & L. G. R. Co.* v. *S. & C. R.R. Co.*, 45 Cal. 680, it was held that: "if a corporation *de facto* is in the actual possession of a public highway, under a grant of a franchise to improve and collect tolls on the same, a mere trespasser can not justify his entry thereon on the ground that it was only a corporation *de facto*, and was not *de jure* entitled to the franchise."

In *Williams* v. *Kokomo B. & L. Ass'n.*, 89 Ind. 339, one Leach gave to an acting corporation his mortgage on real estate. Subsequent to the execution and recording of it, he executed another mortgage on the same land to Williamson. In a proceeding to foreclose the junior mortgage, Williamson maintained that the pretended corporation had no legal existence, by reason of defects and omissions in the proceedings to incorporate, and that the senior mortgage was void. He was in no manner estopped, by dealings with, or recognition of, the first mortgagee to deny its corporate existence. The court held that: "A junior mortgagee can not defeat a senior mortgage by showing that the corporation to which the senior mortgage was executed was defectively organized, if it be a corporation *de facto*." ELLIOT, J., said: "Where persons assume to incorporate under the laws of the State, and in part comply with their requirements, assume corporate functions and transact business as a corporation, private persons can not collaterally question the right of such an association to a corporate existence, although there has not been a full compliance with the provisions of the statute. *Baker* v. *Neff*, 73 Ind. 68. *This rule is not limited to cases where one by contract admits corporate existence, but is a rule of general application.*" It is not easy to distinguish the principle of this case from that of the case at bar.

In *Pape* v. *Capital Bank*, 20 Kan. 440, Pape and wife gave their notes to "James M. Spencer or bearer," and their mortgage on real estate to secure them. Spencer transferred the notes to the Capital Bank of Topeka, an acting corporation, with this indorsement: "Pay the bearer, without recourse on me; James M. Spencer." The mortgage was also transferred to the bank, which proceeded by suit to collect the notes and foreclose the mortgage. Pape and wife interposed the defense that the bank was not, and never had been, a body corporate, by reason, among others, of a defective organization. The bank had assumed corporate functions after an attempt, in good faith, to incorporate, and for a number of years was in the actual and notorious exercise of corporate franchises. Pape had transacted banking business with the plaintiff prior to the purchase of the notes and mortgage, but such business was wholly unconnected with the notes and mortgage in suit. His wife, however, had not in any manner recognized the existence of the bank as a corporate body, and the doctrine of estoppel was not invoked to aid the court in sustaining a judgment of foreclosure against Pape and wife. BREWER, J., says: "The corporation is one *de facto;* and only the State can inquire, and that, in a direct proceeding, whether it be one *de jure*. . . . There must, in such cases, be a law under which the incorporation can be had; there must, also, be an attempt, in good faith, on the part of the corporators, to incorporate under such law; and when, after this, there has been for a series of years an actual, open, and notorious exercise, unchallenged by the State, of the powers of a corporation,

one who is sued on a note held by such corporation will not be permitted to question the validity of the incorporation as a defense to the action. No mere matters of technical omission in the incorporation, no acts of forfeiture from misuser after the incorporation, are subjects of inquiry in such an action. *This is not upon the ground of equitable estoppel but upon grounds of public policy.* If the State, which alone can grant the authority to incorporate, remains silent during the open and notorious assertion and exercise of corporate powers, an individual will not, unless there be some powerful equity on his side, be permitted to raise the inquiry." . . .

In the case at bar, the certificate which was last filed by the society embraced a full statement of the objects of incorporation and indicated what the nature of its business must necessarily be, and was strongly suggestive of the manner in which it must necessarily be transacted; and while it is not our purpose to call in question the action of this court in the *quo warranto* proceedings, we have no hesitation in saying that if we were now called upon to determine whether the corporate life of Society Perun should be taken, the question, upon the facts offered in proof at the trial below, would not be free from doubt and difficulty. It is very clear that the proceedings to incorporate were colorable; and so far as this fact is a test of the existence of a corporation *de facto*, it is most amply established. That there was proof of user is manifest from the evidence which was received without objection.

That the judgment of ouster did not and could not have a retroactive effect upon the rights of the society, and of parties who had dealt with it during its *de facto* existence, is suggested by the opinion of WRIGHT, J., in *Gaff* v. *Flesher*, 33 Ohio St. 115.

The evidence which was offered and excluded would, if credited, have shown Society Perun capable of holding and transferring the legal title to the lands in controversy. *Walsh* v. *Barton*, 24 Ohio St. 43; *Darst* v. *Gale*, 83 Ill. 136; *Shewalter* v. *Pirner*, 55 Mo. 218; *Nat. Bank* v. *Matthews*, 98 U.S. 628; *Goundie* v. *Northampton Water Co.*, 7 Penn. St. 233; *Barrow* v. *Nashville Turn. Co.*, 9 Humph. 304; *Kelly* v. *People's Trans. Co.*, 3 Ore. 189; *Bogardus* v. *Trinity Church*, 4 Sandf. Ch. 758.

The public and all persons dealing with this society were justified in assuming that the certificate filed with the Secretary of State, and by him admitted to record in his office, had been approved by him, and also by the Attorney-General, as required by statute (69 Ohio L. 150), and that it so far conformed to all legal requirements that, as provided in § 2 of the act of incorporation (69 Ohio L. 83), "a copy, duly certified by the Secretary of State, under the great seal of the State of Ohio, shall be evidence of the existence of such association."

It would seem that such approval, record, and certificate, followed by uninterrupted and unchallenged user for nearly six years,

of all of which proof was tendered, would constitute a corporation *de facto*, if such a body is, under any circumstances, entitled to legal recognition.

The highest considerations of public policy and fair dealing protest against treating such an organization as a nullity, and all of its transactions void.

The principle of the above cases is to be distinguished from a case where a mere corporation *de facto* attempts to assert the power of eminent domain by the appropriation of private property to public use. It has been held that the exercise of this right (which is but a delegation of the sovereign power of the State), depends upon the sufficiency and legal validity of the certificate of incorporation and public record of its organization. *R.R. Co.* v. *Sullivant*, 5 Ohio St. 276; *Atkinson* v. *R.R. Co.*, 15 Ohio St. 21.

The case of *Raccoon River Nav. Co.* v. *Eagle*, 29 Ohio St. 238, is relied upon by the defendant in error. It was an action to recover upon a stock subscription. A plea of *nul tiel corporation* was interposed. The plaintiff claimed to be organized under an act to authorize the incorporation of companies "for the purpose of improving any stream of water . . . declared navigable by any law of the State of Ohio." On the trial the plaintiff offered in evidence a certificate by which it appeared that the company was formed for the purpose of improving, etc., Big Raccoon River. Unfortunately there was no navigable stream in Ohio by that name. No other testimony was offered. There was no proof of user. There was no defect in the form of the proceedings to incorporate, but an attempt to organize and incorporate for a purpose impossible of accomplishment. There was neither a *de jure* nor *de facto* corporation. Judgment was properly rendered for defendant.

In excluding proof of what was actually done looking to the incorporation of Society Perun, and of the subsequent acts of user, which was offered in evidence, there was error.

Judgment reversed.

NOTE. — See, *accord*, *Denver* v. *Mullen*, 7 Colo. 345, 358 (lessees of a *de facto* corporation protected); *Duggan* v. *Colorado Co.*, 11 Colo. 113 (mortgagee protected); *Georgia Co.* v. *Mercantile Co.*, 94 Ga. 306 (mortgagee protected); *Finch* v. *Ullman*, 105 Mo. 255 (grantee maintained ejectment); *Crenshaw* v. *Ullman*, 113 Mo. 633; *Lusk* v. *Riggs*, 102 N.W. Rep. 88 (Neb.); *Saunders* v. *Farmer*, 62 N.H. 572 (grantee maintained a writ of entry); *Hackensack Co.* v. *DeKay*, 36 N.J. Eq. 548, 559 (mortgagee protected).

See also the reasoning of the court in *Quinn* v. *Shields*, 62 Ia. 129, 139; *Keene* v. *Van Reuth*, 48 Md. 184, 193; *Elizabethtown Co.* v. *Green*, 49 N.J. Eq. 329, 337; *American Co.* v. *Heidenheimer*, 80 Tex. 344, 348; *Ricketson* v. *Galligan*, 89 Wis. 394. In *Fay* v. *Noble*,

7 Cush. (Mass.) 188, the plaintiff did not ask for relief on this ground.

It is submitted that the courts should go far in denying collateral attack for the benefit of innocent third persons where the only question is whether the corporation by assumption may be a conduit of title. But in *American Trust Co.* v. *Minnesota Co.*, 157 Ill. 641 (no law), and *Bradley* v. *Reppell*, 133 Mo. 545 (expiration of charter), collateral attack was permitted. See, however, *Sherwood* v. *Alvis*, 83 Ala. 115, 118; *Brickley* v. *Edwards*, 131 Ind. 3, 7; *Reynolds* v. *Myers*, 51 Vt. 444, 445; *Smith* v. *Sheeley*, 12 Wall. (U.S.) 358; *County of Leavenworth* v. *Barnes*, 94 U.S. 70.

BREWER *v.* THE STATE.

7 Lea (Tenn.) 682. 1881.

Turney, J., delivered the opinion of the court.

Brewer was indicted and convicted in the circuit court of Hancock county, for selling intoxicating liquors within four miles of "McKinney High School," an incorporated institution of learning.

The proof shows the sale to have been in the town of Sneedville, within four hundred yards of the building in which the school was taught.

The act of 1875, chap. 142, entitled "An act to provide for the organization of corporations," makes provision for the organization of such corporations as the "McKinney High School." The charter of said institution was passed in the form required by law, and was acknowledged and registered and transmitted to the Secretary of State, but his certificate and the *fac simile* of the seal of the State had not been registered in the county at the time of the alleged offense.

By § 3 of the act it is provided: "The said instrument registered as aforesaid, shall be transmitted to the Secretary of State, who shall copy the same in a book to be kept for that purpose, with the probates, acknowledgments, certificates of clerk, register, etc. The Secretary of State shall then certify in the original instrument, that the same has been registered in his office, to which certificate shall be affixed the great seal of the State, and upon the affixing of the great seal of the State to said certificate or said original instrument, and the registration of said Secretary's certificate and the *fac simile* of said seal in the register's office where said instrument was originally registered, the formation of the association as a body politic and corporate is hereby declared complete, and the validity of the same shall not be in any legal proceeding collaterally attacked."

As we have seen, these things were not done when the offense is alleged to have been committed; hence the "McKinney High

School" was not then an incorporated institution in the sense of the statute, the defendant is therefore not guilty of the offense charged.

It is urged on the part of the State that § 20 of the act enacts "that the Secretary of State shall have published and bound with the acts of each general assembly a certified list of all corporations organized under this or any subsequent act of the Legislature, since the last publication, giving the name and date of organization of each corporation, and such publication shall be legal evidence of the existence of such corporations." That this section having been complied with, the offense was complete.

The object of this section was convenience simply. The legal evidence created by it is only *prima facie*, and may be, as it was in this case, rebutted.

Reversed.

EAST NORWAY LAKE CHURCH *v.* FROISLIE.

37 Minn. 447. 1887.

THE plaintiffs in this action are "The Trustees of the East Norway Lake Norwegian Evangelical Lutheran Church of Kandiyohi County, Minnesota," and "The Trustees of the West Norway Lake Norwegian Evangelical Lutheran Church of Kandiyohi County, Minnesota," and they brought the action in the District Court for Kandiyohi County, to recover the possession of certain real property detained by the defendant, and of which the plaintiffs allege that they are the joint owners. The answer denies plaintiffs' incorporation and ownership.

MITCHELL, J. . . . Defendants, however, attack plaintiffs' title. They claim that they were never legally organized, and hence were incapable of taking or holding property. The points made in support of this contention are that the meetings at which the organizations were attempted to be made were not held after sufficient notice; that the certificates of incorporation were not properly executed, acknowledged, or recorded, etc.; and that Sp. Laws 1878, chap. 193, purporting to legalize the organizations, is unconstitutional. Under the view we take of the case it is wholly unnecessary to consider any of these questions. The plaintiffs are at least corporations *de facto*. Such a corporation, at least where there is a law under which a corporation might have been legally formed with such power, is capable of taking and holding property as grantee as well as a corporation *de jure*, and conveyances to it are valid as to all the world, except the state in proceedings in *quo warranto*, or other direct proceedings to inquire into its right to exercise corporate franchises. And in an action by it to recover such property, no private person will be allowed to inquire collaterally into the regularity of its organization.

This rule is not founded upon any principle of estoppel, as is sometimes assumed, but upon the broader principles of common justice and public policy. It would be unjust and intolerable if, under such circumstances, every interloper and intruder were allowed thus to take advantage of every informality or irregularity of organization.

Judgment affirmed.

NOTE. — There is authority that if a conveyance purports to run to a corporation, and there is no corporation *de jure*, the deed is void, and the grantor may successfully assert title to the land or chattels against the associates. *Harriman* v. *Southam*, 16 Ind. 190 (overruled in *Snyder* v. *Studebaker*, 19 Ind. 462); *Whiting* v. *Barton*, 204 Mass. 169; *Douthitt* v. *Stinson*, 63 Mo. 268 (distinguished in *Reinhard* v. *Virginia Co.*, 107 Mo. 616, and *White Oak Society* v. *Murray*, 145 Mo. 622); *White* v. *Campbell*, 5 Humph. (Tenn.) 38; *Russell* v. *Topping*, 5 McLean (U.S.) 194, 202 (but this cannot stand after *Smith* v. *Sheeley*, 12 Wall. (U.S.) 358).

But by the weight of authority it is held that (at least if there is a *de facto* corporation in the restricted sense stated in the note to *Boyce* v. *Towsontown Station*, *supra*) the transferor and those in privity with him are estopped to assert title. *Cahall* v. *Citizens Ass'n*, 61 Ala. 232; *Bates* v. *Wilson*, 14 Colo. 140; *Thompson* v. *Candor*, 60 Ill. 244; *Baker* v. *Neff*, 73 Ind. 68; *Williamson* v. *Kokomo Ass'n*, 89 Ind. 389 (junior mortgagee cannot defeat prior mortgage to *de facto* corporation); *Sword* v. *Wickersham*, 29 Kan. 746; *Reinhard* v. *Virginia Co.*, 107 Mo. 616; *Frost* v. *Frostburg Co.*, 24 How. (U.S.) 278. And in *Otol Ass'n* v. *Doman*, 95 N.W. (Neb.) 327, a *de facto* corporation maintained a proceeding against its grantor for reformation of the deed.

Where the associates have expended money for the transfer or on the property transferred, they will at least be protected in equity. See *Walker* v. *Taylor*, 252 Ill. 424, 430; *Johnson* v. *Northern Trust Co.*, 265 Ill. 263; *Whipple* v. *Parker*, 29 Mich. 369, 381.

It is submitted that the courts should go further. The circumstances frequently are such that to vest the title in the associates would more nearly accord with the intent of the parties than to declare the title to be still in the transferor. Under such circumstances, if the transfer fails, as a transfer to a corporation, it ought to be held to avail, as a transfer to the associates.

In *Maugham* v. *Sharpe*, 17 C.B. (N.S.) 443, chattels were mortgaged to "The City Investment and Advance Company." The mortgagor believed he was conveying to a corporation (*per* ERLE, C.J., at p. 462); but there was no such corporation authorized by the State. The court held that the title passed to the individuals doing business under that name. WILLIAMS, J., said (p. 463): "I apprehend, the meaning of the grant is plain: the deed purports and intends to convey the goods to those persons who use the style and firm of the City

Investment and Advance Company. They may or may not be a corporation; but when it is ascertained that those who carry on business under that name are the defendants, the deed operates to convey the property to them." *Jones* v. *Aspen Co.*, 21 Colo. 263, 271; *New Haven Wire Co. Cases*, 57 Conn. 352, 394; *accord.* See also *Farnsworth* v. *Drake*, 11 Ind. 101; *Fay* v. *Noble*, 7 Cush. (Mass.) 188, 194; *American Silk Works* v. *Salomon*, 6 T. & C. (N.Y.) 352.

The English courts would follow *Maugham* v. *Sharpe*, if the subject of the conveyance was realty. *Wray* v. *Wray*, [1905] 2 Ch. 349. In *Byam* v. *Bickford*, 140 Mass. 31, DEVENS, J., said (p. 32): "But the South Chelmsford Hall Association was a body well known, all the members of which could be ascertained; and, as it could not take as a corporation, the deed may properly be construed as a grant of the estate to those who were properly described by this title. . . . The persons associated in the society were thus tenants in common of the land conveyed." See also *Hart* v. *Seymour*, 147 Ill. 598, 610; *Clifton Heights Co.* v. *Randell*, 82 Ia. 89.

Where a transfer of property has been made, in form, to a corporation, and the title is in the associates, as many, if not in them as a corporation, the court should not, it is submitted, permit collateral attack upon the due incorporation of the associates by a person who has illegally interfered with that property.

If there is a transfer to a *de facto* corporation (in the restricted sense stated above), the authorities permit a suit by the *de facto* corporation against any person who illegally interferes with that property. In *accord* with the principal case, see *Chiniquy* v. *Bishop of Chicago*, 41 Ill. 148; *Cincinnati Co.* v. *Danville Co.*, 75 Ill. 113 (injunction to restrain irreparable injury to property); *Williams* v. *Citizens Co.*, 130 Ind. 71 (same); *Buffalo Co.* v. *Cary*, 26 N.Y. 75, 77–78; *Remington Co.* v. *O'Dougherty*, 65 N.Y. 570 (conversion); *Persse Works* v. *Willett*, 1 Rob. N.Y. 131 (trespass upon personality); *American Silk Works* v. *Salomon*, 6 T. & C. (N.Y.) 352 (conversion); *Elizabeth Academy* v. *Lindsey*, 6 Ired. (N.C.) 476 (conversion); *Searsburgh Co.* v. *Cutler*, 6 Vt. 315, 323 ("For the purpose . . . of protecting the property . . . from tort-feasors, it is enough to show a corporation *de facto*"); *Baltimore Co.* v. *Baptist Church*, 137 U.S. 568, 572 (nuisance. A *de facto* corporation may maintain an action "against any one . . . who has done it a wrong"); *American Co.* v. *New York*, 68 Fed. 227. But *cf.* *Proprietors of Southold* v. *Horton*, 6 Hill (N.Y.) 501; *Augusta Co.* v. *Vertrees*, 4 Lea (Tenn.) 75; *Slocum* v. *Providence Co.*, 10 R.I. 112, 114.

Similarly, an association *de facto* may recover for use and occupation of land. *Philippine Sugar Co.* v. *United States*, 39 Ct. Cl. 225.

Similarly, a *de facto* corporation may maintain proceedings to remove a cloud on the title of land conveyed to it. *Keyes* v. *Smith*, 67 N.J.L. 190.

Similarly, if the holder of a note indorses it to a *de facto* corporation, such corporation may enforce the note against the parties thereto. *Cozzens* v. *Chicago Co.*, 166 Ill. 213; *Wilcox* v. *Toledo Co.*, 43 Mich. 584, 590; *Haas* v. *Bank of Commerce*, 41 Neb. 754.

It is submitted that collateral attack may properly under some circumstances be denied to a wrongdoer, even if there was not a *de facto* corporation (in the restricted sense stated above). Cf. *Winget* v. *Quincy Building Ass'n*, 128 Ill. 67, *supra; Stoutimore* v. *Clark*, 70 Mo. 471, *supra; Wilder Mfg. Co.* v. *Corn Products Refining Co.*, 236 U.S. 165, *supra.*

But in *American. Trust Co.* v. *Minnesota Co.*, 157 Ill. 641, the courts announce the doctrine that no suit against a wrongdoer will be permitted in the name of the corporation, if there was no law under which such a corporation could have been legally formed. See also *Johnson* v. *Northern Trust Co.*, 265 Ill. 263.

INDIANAPOLIS FURNACE CO. *v.* HERKIMER.

46 Ind. 142. 1874.

COMPLAINT by the appellant against the appellee on the following paper subscribed by the defendant: —

"Articles of association of the Indianapolis Furnace and Mining Company, organized for the purpose of operating in the counties of Marion and Clay, in the State of Indiana.

"Article First. The name of said company shall be the Indianapolis Furnace and Mining Company.

"Article Second. The capital stock of said company shall be one hundred thousand dollars, and be divided into shares of fifty dollars each, to be paid for in such amounts and at such times as may be ordered by the board of directors.

"Article Third. The stockholders shall elect directors, who shall from their number elect a president, secretary, and treasurer, who shall hold their office for one year and until their successors are elected and qualified.

"Article Fourth. The board of directors shall have the control and management of the business of the company, except as they may appoint some one or more persons to take charge of the same, in which case the record of the action of the board in appointing them shall be evidence of their authority to act for said company.

"Article Fifth. The board of directors shall have power to make assessments on stock, collect the same, issue certificates therefor, and declare and pay dividends, which shall be at least twice a year.

"Article Sixth. All the expense incurred by the company shall be paid, and all the indebtedness of the same shall likewise be discharged

before any dividends shall be paid to the stockholders, unless the directors shall direct otherwise.

"Article Seventh. We, the undersigned, hereby subscribe to all the foregoing articles, provisions, conditions, and stipulations, and agree to the organization of a company as therein stated, binding ourselves to take and pay for the number of shares of stock set opposite our names respectively, and pay for the same at such times and in such amounts as the board of directors may order the same to be paid for, without relief from valuation or appraisement laws.

"Subscribers' Names.	No. of Shares.
"J. D. Herkimer, by D. Root,	100."

WORDEN, J. The articles of association signed by the defendant, including his subscription for stock, were very clearly mere preliminary articles, contemplating a future perfection of the organization as a corporation. The defendant's contract did not purport to be with an existing corporation, but with one to be brought into existence in the future. The averment in the complaint that the plaintiff was, at the time the subscription was made, an existing corporation, cannot change the nature and legal effect of the defendant's contract. That contract was, in legal effect, that the defendant would take and pay for the stock subscribed for, in case the organization should be perfected and the corporation brought into legal existence, and not otherwise. Such preliminary subscriptions seem to enure to the benefit of the corporation when formed. *Heaston* v. *The Cincinnati, etc., Railroad Co., supra.*

But unless the subsequent steps, necessary to bring into existence the corporation, were taken, there was no corporation to whose benefit the contract could enure, and the defendant could not be liable; and it should have been averred in the complaint that such steps had been taken. *Wert* v. *The Crawfordsville and Alamo Turnpike Co.*, 19 Ind. 242; *Williams* v. *The Franklin Township Academical Association*, 26 Ind. 310.

In such case, the estoppel growing out of a contract with a party as an existing corporation does not apply. In the case last cited the court say:

"This rule of estoppel does not apply to a suit brought on a subscription made with a view to the organization of a corporation, and as preliminary thereto, where other acts are required by the law as a condition precedent to the exercise of corporate powers."

[The court held that the conditions precedent to the formation of a corporation had not been performed, and that therefore the defendant could not be required to pay for the stock subscribed.]

NOTE. — See, *accord*, *Schloss* v. *Montgomery Co.*, 87 Ala. 411; *Nelson* v. *Blakey*, 47 Ind. 38; *Reed* v. *Richmond Co.*, 50 Ind. 342, 83 Ind. 9; *Rikhoff* v. *Brown's Co.*, 68 Ind. 388; *Coppage* v. *Hutton*, 124

Ind. 401; *Allman* v. *Havana Co.*, 88 Ill. 521; *Richmond Ass'n* v. *Clarke*, 61 Me. 351; *Taggart* v. *Western Co.*, 24 Md. 563; *Katama Land Co.* v. *Holley*, 129 Mass. 540; *Columbia Co.* v. *Dixon*, 46 Minn. 463, 465; *Capps* v. *Hastings Co.*, 40 Neb. 470; *Dorris* v. *Sweeney*, 60 N.Y. 463; *Greenbrier Exposition* v. *Rodes*, 37 W.Va. 738. See also *McIntire* v. *McLain Ass'n*, 40 Ind. 104; *Stowe* v. *Flagg*, 72 Ill. 397; *Mansfield Co.* v. *Drinker*, 30 Mich. 124; *Crocker* v. *Crane*, 21 Wend. (N.Y.) 211; *Wilmington Co.* v. *Wright*, 5 Jones (N.C.) 304. But *cf.* *Willard* v. *Church of Rockville Centre*, 66 Ill. 55.

NEW YORK CABLE CO. *v.* MAYOR, ETC., OF NEW YORK.

104 N.Y. 1. 1887.

APPEAL from order of the General Term of the Supreme Court in the first judicial department, made December 1, 1884, denying a motion on the part of the petitioner, the New York Cable Railway Company, to confirm the report of commissioners appointed by the Supreme Court to determine whether the railways described in the petition of said company ought to be constructed and operated.

The report of the commissioners was in favor of the petitioner. The refusal to confirm their report was upon the ground that the petitioner had no legal right to construct or operate a railway.

RAPALLO, J. . . . *Third.* It is claimed that this court overlooked the authorities cited on the appellants' points, to the effect that a defect in articles of association or in the affidavits annexed thereto, is not fatal to the existence of a corporation or its faculty to acquire franchises, but that the State alone can interpose and take advantage of such defects.

This court did not deem it necessary to comment in its opinion upon those authorities, for the simple reason that we did not deem them applicable to the case at bar. In order to sustain proceedings by which a body claims to be a corporation, and as such empowered to exercise the right of eminent domain, and under that right to take the property of a citizen, it is not sufficient that it be a corporation *de facto.* It must be a corporation *de jure.* Where it is sought to take the property of an individual under powers granted by an act of the legislature to a corporation to be formed in a particular manner the constitutional protection of the rights of private property requires that the powers granted by the legislature be strictly pursued, and all the prescribed conditions be performed. Where the power is conferred upon a corporation, duly formed, it will not be defeated simply because the corporation has done or omitted some act which may be a *cause* of forfeiture of its rights and franchises, for it rests with the State to determine whether such forfeiture will be enforced.

Judicial proceedings are necessary to enforce such a forfeiture, and it may be waived. That was the point to which the opinion in the matter of the *Brooklyn, etc., Railroad Company* (72 N.Y. 245), cited by the appellant was directed. It was assumed that this distinction was well understood, and a considerable portion of the opinion of this court in the present case was devoted to showing that the omissions and defects in the organization of the company were failures to comply with the conditions precedent to the existence of the petitioner as a corporation, and the exercise by it of the right of eminent domain, instead of being mere causes of forfeiture of rights acquired.

NOTE. — See, *accord*, *Piper* v. *Rhodes*, 30 Ind. 309 (assessment by *de facto* turnpike company); *McIntire* v. *McLain Ass'n*, 40 Ind. 104 (assessment by *de facto* drainage company); *Newton Co.* v. *Nofsinger*, 43 Ind. 566 (same); *Knight* v. *Flatrock Co.*, 45 Ind. 134 (assessment of tax in aid of *de facto* turnpike company); *Williamson* v. *Kokomo Ass'n*, 89 Ind. 389, 392 (condemnation); *Hopkins* v. *Kansas City Co.*, 79 Mo. 98 (condemnation); *St. Joseph Co.* v. *Shambaugh*, 106 Mo. 557, 566 (condemnation); *Hampton* v. *Clinton Co.*, 65 N.J.L. 158, 160 ("There is no doubt that non-compliance with conditions precedent to incorporation will defeat a condemnation"); *Matter of Union Co.*, 112 N.Y. 61 (condemnation); *Matter of New York Co.*, 35 Hun (N.Y.) 220 (same. On appeal, 99 N.Y. 12); *Matter of Broadway Co.*, 73 Hun (N.Y.) 7, 13 (same); *Kinston Co.* v. *Stroud*, 132 N.C. 413 (same. *Cf. Wellington Co.* v. *Cashie Co.*, 114 N.C. 690); *Atlantic Co.* v. *Sullivant*, 5 Ohio St. 276 (same); *Atkinson* v. *Marietta Co.*, 15 Ohio St. 21 (same); *Powers* v. *Hazelton Co.*, 33 Ohio St. 429 (same); *Tulare District* v. *Shepard*, 185 U.S. 1, 17 (same). See also *Niemeyer* v. *Little Rock Ry.*, 43 Ark. 111; *Fales* v. *Whiting*, 7 Pick. (Mass.) 225; *Trenton Co.* v. *United Co.*, 60 N.J. Eq. 500; *Farnham* v. *Benedict*, 107 N.Y. 159; *New Orleans Co.* v. *Louisiana Co.*, 11 Fed. 277.

In *Sisters of Charity* v. *Morris Railroad Co.*, 84 N.J.L. 310, it was held that when in proceedings to condemn land by a corporation, the facts as to due incorporation are questioned or the inferences are disputable, the proceedings should be held until the legality of the corporation can be settled once for all upon an information by the Attorney-General.

There is considerable authority *contra* to the principal case. *Central of Georgia Co.* v. *Union Springs Co.*, 144 Ala. 639; *McAuley* v. *Columbus Co.*, 83 Ill. 348; *Peoria Co.* v. *Peoria Co.*, 105 Ill. 110; *Chicago Co.* v. *Chicago Co.*, 112 Ill. 589; *Morrison* v. *Forman*, 177 Ill. 427; *Eddleman* v. *Union Co.*, 217 Ill. 409, 414; *Detroit Co.* v. *Campbell*, 140 Mich. 384, 394 (relying on 44 Mich. 387, and 81 Mich. 378, which only decided that the question could not be litigated in *certiorari* proceedings); *Postal Co.* v. *Oregon Co.*, 23 Utah, 474, 482. See also *Osborn* v. *People*, 103 Ill. 224; *Ward* v. *Minnesota Co.*, 119

Ill. 287; *Reisner* v. *Strong*, 24 Kan. 410, 417; *Portland Co.* v. *Bobb*, 88 Ky. 226; *Farnham* v. *Delaware Co.*, 61 Pa. St. 265. But note the explanation of the Illinois doctrine made in *Henry* v. *Centralia Co.*, 121 Ill. 264, 267.

GUCKERT *v.* HACKE.

159 Pa. 303. 1893.

At the trial before Porter, J., it appeared that plaintiff entered into a contract to make some alterations and repairs in a building occupied by the Hughes & Gawthrop Co. In October, 1890, a certificate of incorporation in proper form was presented by the Hughes & Gawthrop Co. to the governor, asking for a charter. The certificate was approved and letters patent were duly issued. All of the details required by the act of April 29, 1874, P.L. 77, were complied with, excepting only the recording of the certificate in the recorder's office of Allegheny County. The certificate was not recorded until June, 1891. In the mean time, plaintiff, without knowledge of the incorporation, made the contract with Gawthrop, upon which he sued. Subsequently he accepted a note for the debt, signed with the corporate name.

Mr. Chief Justice Sterrett. It is essential to the creation of a corporation under an enabling statute that all material provisions should be substantially followed; and, exemption from personal liability being one of the chief characteristics distinguishing corporations from partnerships and unincorporated joint-stock companies, it follows that those who transact business upon the strength of an organization which is materially defective are individually liable, as partners, to those with whom they have dealt. What provisions are material must be gathered from the relation of each to the purpose and scope of the act; and when, therefore, successive steps are prescribed for the creation of corporations, these must obviously be regarded as imperative. Enabling statutes, on the principle of *expressio unius est exclusio alterius*, impliedly prohibit any other mode of doing the act which they authorize; they must be strictly construed: Sutherland on Stat. Construction, § 454. Hence it has been uniformly held that requirements in respect of filing charters are imperative: *Childs* v. *Smith*, 55 Barb. 45; *Smith* v. *Warden*, 86 Mo. 382; *Abbott* v. *Smelting Co.*, 4 Neb. 416; Beach on Corporations, § 162.

It is plain even from a cursory reading of the Act of April 29, 1874, P.L. 77, that recording of the certificate "in the office for the recording of deeds, in and for the county where the chief operations are to be carried on," was intended to be made one of the conditions precedent to corporate existence. That was the last of successive steps required to be taken, and the right to begin the transaction of cor-

porate business was made to depend upon the taking of that step. "From thenceforth," the act expressly declares, the subscribers and their associates and successors "shall be a corporation for the purposes and upon the terms named in the said charter." One of the purposes of the act being exemption from personal liability in the transaction of business, it is obviously material that the public should have notice, and notice by record was accordingly prescribed. Failure to record was failure to comply with one of the express conditions of incorporation, and consequently of exemption from liability.

It may be conceded that had plaintiff dealt with defendants as a corporation he would have been estopped from claiming against them in any other capacity, even though they failed to record their charter: *Spahr* v. *Bank*, 94 Pa. 429. But it is not pretended that he had any knowledge of the existence of the charter; and there was certainly nothing, either in the name under which they did business or in their conduct, which should have put him upon inquiry. In these circumstances he was amply justified in dealing with them as partners. It was through their default — not his — that they were so treated; and it would be manifest injustice that he should lose his admittedly honest claim.

In the absence of an express agreement the acceptance of a note from the defendants, as a corporation, after plaintiff had performed his part of the contract, cannot operate by way of election or estoppel. The relation of the parties was fixed by their status when the original contract was made, and cannot be changed by gratuitous inference. The members of the alleged corporation were the defendants, and were not injured by the acceptance of the note. The principle which treats the acceptance of a note as additional security to and not as satisfaction of a mechanic's lien (*Jones* v. *Shawhan*, 4 W. & S. 257) is, with even more justice, applicable here.

It follows from what has been said that the instructions complained of are erroneous.

Judgment reversed and a *venire facias de novo* awarded.

NOTE. — See, *accord*, *Christian Co.* v. *Lumber Co.*, 121 Ala. 340; *Field* v. *Cooks*, 16 La. Ann. 153; *N.Y. Bank* v. *Crowell*, 177 Pa. St. 313; *Slocum* v. *Head*, 105 Wis. 431; *Clausen* v. *Head*, 110 Wis. 405. See also *Williams* v. *Hewitt*, 47 La. Ann. 1076, 1082; *Johnson* v. *Okerstrom*, 70 Minn. 303, 311; *Queen City Co.* v. *Crawford*, 127 Mo. 356, 363; *Vanhorn* v. *Corcoran*, 127 Pa. St. 255, 268 (*cf. Allegheny Bank* v. *Bailey*, 147 Pa. St. 111); *Mitchell* v. *Jensen*, 29 Utah, 346, 360.

As to the liability of the associates for a tort committed by an agent, see the article in 20 H.L.R. 456, and particularly note 30 on p. 474.

CHAPTER II.

COLLATERAL ATTACK UPON THE POWERS OF A CORPORATION. HEREIN OF THE EXPRESSION "ULTRA VIRES."

SECTION 1.

THE ENGLISH AUTHORITIES.

BRITISH SOUTH AFRICA CO. *v.* DE BEERS CONSOLIDATED MINES, LTD.

[1910] 1 Ch. 354.

THE plaintiff was incorporated by Royal charter dated October 29, 1889, for the purpose of carrying on certain operations in South Africa. The powers granted it were extensive, but the charter contained the following: "Nothing in this our charter shall be deemed to authorize the company to set up or grant any monopoly of trade." The plaintiff asked the court to declare that a certain exclusive license granted (in form) by it to the defendant was void as being a monopoly, and therefore *ultra vires* the plaintiff. The court was of opinion that the exclusive license did not amount to a monopoly, but gave the following opinion as to the effect of an *ultra vires* act by the plaintiff.

SWINFEN EADY, J. It must not be assumed that, if a chartered company does some act which it is forbidden to do by its charter, that act is necessarily void as *ultra vires*.

In *Riche* v. *Ashbury Railway Carriage and Iron Co.*, L.R. 9 Ex. 224, all the judges in the Exchequer Chamber agreed that a corporation at common law has as an incident given by law the same power to contract and subject to the same restrictions that a natural person has, although the court was equally divided upon the question whether the acts which were *ultra vires* a statutory corporation were capable of ratification.

BLACKBURN, J., in delivering the judgment of himself, BRETT and GROVE, JJ., which so far as regards a statutory corporation was overruled by the House of Lords, referred to *Sutton's Hospital Case*, 10 Rep. 1a, 30b, and said (L.R. 9 Ex. 263): "This seems to me an express authority that at common law it is an incident to a corporation

to use its common seal for the purpose of binding itself to anything to which a natural person could bind himself, and to deal with its property as a natural person might deal with his own. And further, that an attempt to forbid this on the part of the King, even by express negative words, does not bind at law. Nor am I aware of any authority in conflict with this case. If there are conditions contained in the charter that the corporation shall not do particular things, and these things are nevertheless done, it gives ground for a proceeding by *sci. fa.* in the name of the Crown to repeal the letters patent creating the corporation: see *Eastern Archipelago Co.* v. *Reg.*, (1853) 2 E. & B. 856. But if the Crown take no such steps, it does not, as I conceive, lie in the mouth either of the corporation, or of the person who has contracted with it, to say that the contract into which they have entered was void as beyond the capacity of the corporation. I am aware of no decision by which a corporation at common law has been permitted to do so. I take it that the true rule of law is, that a corporation at common law has, as an incident given by law, the same power to contract, and subject to the same restrictions, that a natural person has."

ARCHIBALD, J., in delivering the judgment of himself, KEATING and QUAIN, JJ., whose opinion as regards a statutory corporation ultimately prevailed in the House of Lords, said (L.R. 9 Ex. 292): "I admit that at common law (as was resolved in the case of *Sutton's Hospital*, 10 Rep. 1a, 30b), when a corporation is duly created all other incidents are tacite annexed, such as ability to purchase and alien, to sue and be sued, and to use what seal they will; and that even a clause in their charter restraining them from aliening or demising but in a certain form, though an ordinance testifying the desire of the Crown, is to be deemed but a precept and not binding in law, so that a corporation thus constituted acquires rights of contracting as extensive as those of a natural person."

In *Baroness Wenlock* v. *River Dee Co.*, 36 Ch.D. 675, n., 685, n., BOWEN, L.J. says: "At common law a corporation created by the King's charter has, *prima facie*, and has been known to have ever since *Sutton's Hospital Case*, 10 Rep. 1a, 30b, the power to do with its property all such acts as an ordinary person can do, and to bind itself to such contracts as an ordinary person can bind himself to; and even if by the charter creating the corporation the King imposes some direction which would have the effect of limiting the natural capacity of the body of which he is speaking, the common law has always held that the direction of the King might be enforced through the Attorney-General; but although it might contain an essential part of the so-called bargain between the Crown and the corporation, that did not at law destroy the legal power of the body which the King had created."

At p. 11 of the 9th edition of his work on the Companies Acts

Buckley, L.J., states the law thus: "At common law a corporation created by charter can by its common seal bind itself to anything to which a natural person could bind himself, and can deal with its property as a natural person might deal with his own. So that not only can the chartered company bind itself by acts as to which no power is affirmatively given by the charter, but even if the charter by express negative words forbid any particular act, the corporation can nevertheless at common law do the act, and if it does it, is bound thereby, and the result is only that ground is given for a proceeding by *scire facias* in the name of the Crown, repealing the charter."

If it were necessary to determine the question, I should decide that the objection raised by the plaintiff company that the agreements are not binding because they are *ultra vires* wholly fails.

ASHBURY RAILWAY CARRIAGE AND IRON CO. *v.* RICHE.

L.R. 7 H.L. 653. 1875.

A company called "the Ashbury Railway Carriage and Iron Co." was incorporated under the Companies Act, 1862. (25 & 26 Vict. chap. 89.)

The memorandum of association of the said company contained the following: "The objects for which the company is established are to make and sell, or lend on hire, railway-carriages and waggons, and all kinds of railway plant, fittings, machinery, and rolling-stock; to carry on the business of mechanical engineers and general contractors; to purchase and sell, as merchants, timber, coal, metals, or other materials; and to buy and sell any such materials on commission, or as agents."

The directors of the Ashbury Company entered into an arrangement, in behalf of the company, under which the Messrs. Riche were to construct a railway in Belgium, and the Ashbury Company was to supply the funds for the payment of this construction work.

The plaintiffs claimed that this contract had been ratified by the stockholders of the Ashbury Company.

Later, the Ashbury Company repudiated this contract as being *ultra vires*. Messrs. Riche brought this action for damages for breach of contract.

Lord Cairns, *Lord Chancellor*. [After holding that the contract in question was *ultra vires* of the Ashbury Company.]

Those being the results of the documents to which I have referred, I will ask your Lordships now to consider the effect of the act of Parliament — the Joint Stock Companies Act of 1862 — on this

state of things. And here, my Lords, I cannot but regret that by the two judges in the Court of Exchequer the accurate and precise bearing of that act of Parliament upon the present case appears to me to have been entirely overlooked or misapprehended; and that in the Court of Exchequer Chamber, speaking of the opinion of those learned judges who thought that the decision of the Court of Exchequer should be maintained, the weight which was given to the provisions of this act of Parliament appears to me to have entirely fallen short of that which ought to have been given to it. Your Lordships are well aware that this is the act which put upon its present permanent footing the regulation of joint-stock companies, and more especially of those joint-stock companies which were to be authorized to trade with a limit to their liability.

The provisions under which that system of limiting liability was inaugurated, were provisions not merely, perhaps I might say not mainly, for the benefit of the shareholders for the time being in the company, but were enactments intended also to provide for the interests of two other very important bodies; in the first place, those who might become shareholders in succession to the persons who were shareholders for the time being; and secondly, the outside public, and more particularly those who might be creditors of companies of this kind. And I will ask your Lordships to observe, as I refer to some of the clauses, the marked and entire difference there is between the two documents which form the title deeds of companies of this description — I mean the Memorandum of Association on the one hand, and the Articles of Association on the other hand. With regard to the memorandum of association, your Lordships will find, as has often already been pointed out, although it appears somewhat to have been overlooked in the present case, that that is, as it were, the charter, and defines the limitation of the powers of a company to be established under the act. With regard to the articles of association, those articles play a part subsidiary to the memorandum of association. They accept the memorandum of association as the charter of incorporation of the company, and so accepting it, the articles proceed to define the duties, the rights and the powers of the governing body as between themselves and the company at large, and the mode and form in which the business of the company is to be carried on, and the mode and form in which changes in the internal regulations of the company may from time to time be made. With regard, therefore, to the memorandum of association, if you find anything which goes beyond that memorandum, or is not warranted by it, the question will arise whether that which is so done is *ultra vires*, not only of the directors of the company but of the company itself. With regard to the articles of association, if you find anything which, still keeping within the memorandum of association, is a violation of the articles of association, or

in excess of them, the question will arise whether that is anything more than an act *extra vires* the directors, but *intra vires* the company.

The clauses of the statute to which it is necessary to refer are four: in the first place, the sixth clause. That provides that "Any seven or more persons associated for any lawful purpose may, by subscribing their names to a memorandum of association, and otherwise complying with the requisitions of this Act in respect of registration, form an incorporated company, with or without limited liability." My Lords, this is the first section which speaks of the incorporation of the company; but your Lordships will observe that it does not speak of that incorporation as the creation of a corporation with inherent common law rights, such rights as are by common law possessed by every corporation, and without any other limit than would by common law be assigned to them, but it speaks of the company being incorporated with reference to a memorandum of association; and you are referred thereby to the provisions which subsequently are to be found upon the subject of that memorandum of association.

The next clause which is material is the eighth: "Where a company is formed on the principle of having the liability of its members limited to the amount unpaid on their shares, hereinafter referred to as a company limited by shares, the Memorandum of Association shall contain the following things" (I pass over the first and second, and I come to the third item which is to be specified): "The objects for which the proposed company is to be established." That is, therefore, the memorandum which the persons are to sign as a preliminary to the incorporation of the company. They are to state "the objects for which the proposed company is to be established"; and the existence, the coming into existence, of the company is to be an existence, and to be a coming into existence for those objects and for those objects alone.

Then, my Lords, the eleventh section provides: "The memorandum of association shall bear the same stamp as if it were a deed, and shall be signed by each subscriber in the presence of, and be attested by, one witness at the least, and that attestation shall be a sufficient attestation in *Scotland*, as well as in *England* and *Ireland*. It shall, when registered, bind the company and the members thereof to the same extent as if each member had subscribed his name and affixed his seal thereto, and there were in the memorandum contained, on the part of himself, his heirs, executors, and administrators, a covenant to observe all the conditions of such memorandum, subject to the provisions of this act." Your Lordships will observe, therefore, that it is to be a covenant in which every member of the company is to covenant that he will observe the conditions of the memorandum, one of which is that the objects

for which the company is established are the objects mentioned in the memorandum, and that he not only will observe that, but will observe it subject to the provisions of this act. Well, but the very next provision of the act contained in the twelfth section is this: "Any company limited by shares may so far modify the conditions contained in its memorandum of association, if authorized to do so by its regulations as originally framed, or as altered by special resolution in manner hereinafter mentioned, as to increase its capital by the issue of new shares of such amount as it thinks expedient, or to consolidate and divide its capital into shares of larger amount than its existing shares, or to convert its paid-up shares into stock, but, save as aforesaid, and save as is hereinafter provided in the case of a change of name, no alteration shall be made by any company in the conditions contained in its memorandum of association." The covenant, therefore, is not merely that every member will observe the conditions upon which the company is established, but that no change shall be made in those conditions; and if there is a covenant that no change shall be made in the objects for which the company is established, I apprehend that that includes within it the engagement that no object shall be pursued by the company, or attempted to be attained by the company in practice, except an object which is mentioned in the memorandum of association.

Now, my Lords, if that is so — if that is the condition upon which the corporation is established — if that is the purpose for which the corporation is established — it is a mode of incorporation which contains in it both that which is affirmative and that which is negative. It states affirmatively the ambit and extent of vitality and power which by law are given to the corporation, and it states, if it is necessary so to state, negatively, that nothing shall be done beyond that ambit, and that no attempt shall be made to use the corporate life for any other purpose than that which is so specified.

Now, my Lords, with regard to the articles of association, observe how completely different the character of the legislation is. The fourteenth section deals with those articles: "The memorandum of association may, in the case of a company limited by shares, and shall, in the case of a company limited by guarantie, or unlimited, be accompanied, when registered, by articles of association, signed by the subscribers to the memorandum of association, and prescribing such regulations for the company as the subscribers to the memorandum of association deem expedient." They are to be the masters of the regulations which (always keeping within the limit allowed by law) they may deem expedient for the internal regulation of the company. "The articles shall be expressed in separate paragraphs, numbered arithmetically. They may adopt also any of the provisions contained in the table marked A. in the first schedule hereto." I need not read the remainder of that section.

But your Lordships must take, in connection with that, the fiftieth section of the act. That provides that "subject to the provisions of this act, and to the conditions contained in the memorandum of association, any company formed under this act may, in general meeting, from time to time, by passing a special resolution in manner hereinafter mentioned, alter all or any of the regulations of the company contained in the articles of association, or in the table marked A. in the first schedule, where such table is applicable to the company, or make new regulations to the exclusion of, or in addition to, all or any of the regulations of the company." Of the internal regulations of the company the members of it are absolute masters, and, provided they pursue the course marked out in the act, that is to say, holding a general meeting and obtaining the consent of the shareholders, they may alter those regulations from time to time; but all must be done in the way of alteration subject to the conditions contained in the memorandum of association. That is to override and overrule any provisions of the articles which may be at variance with it. The memorandum of association is, as it were, the area beyond which the action of the company cannot go; inside that area the shareholders may make such regulations for their own government as they think fit.

My Lords, that reference to the act will enable me to dispose of a provision in the articles of association in the present case which was hardly dwelt upon in argument, but which I refer to in order that it may not be supposed to have been overlooked. It appears that there has come into the articles of association of this company one which is in these words: "An extension of the company's business beyond or for other than the objects or purposes expressed or implied in the memorandum of association shall take place only in pursuance of a special resolution." In point of fact, no resolution for the extension of the business of the company was in this case come to; but even if it had been come to, it would have been entirely inept and inefficacious. There was, in this fourth article, an attempt to do the very thing which, by the act of Parliament, was prohibited to be done — to claim and arrogate to the company a power under the guise of internal regulation to go beyond the objects or purposes expressed or implied in the memorandum.

Now, my Lords, bearing in mind the difference which I have just taken the liberty of pointing out to your Lordships between the memorandum and the articles, we arrive at once at all which appears to me to be necessary for the purpose of deciding this case. I have used the expressions *extra vires* and *intra vires*. I prefer either expression very much to one which occasionally has been used in the judgments in the present case, and has also been used in other cases, the expression "illegality."

In a case such as that which your Lordships have now to deal

with, it is not a question whether the contract sued upon involves that which is *malum prohibitum* or *malum in se*, or is a contract contrary to public policy, and illegal in itself. I assume the contract in itself to be perfectly legal, to have nothing in it obnoxious to the doctrine involved in the expressions which I have used. The question is not as to the legality of the contract; the question is as to the competency and power of the company to make the contract. Now, I am clearly of opinion that this contract was entirely, as I have said, beyond the objects in the memorandum of association. If so, it was thereby placed beyond the powers of the company to make the contract. If so, my Lords, it is not a question whether the contract ever was ratified or was not ratified. If it was a contract void at its beginning, it was void because the company could not make the contract. If every shareholder of the company had been in the room, and every shareholder of the company had said, "That is a contract which we desire to make, which we authorize the directors to make, to which we sanction the placing the seal of the company," the case would not have stood in any different position from that in which it stands now. The shareholders would thereby, by unanimous consent, have been attempting to do the very thing which, by the act of Parliament, they were prohibited from doing.

But, my Lords, if the shareholders of this company could not *ab ante* have authorized a contract of this kind to be made, how could they subsequently sanction the contract after it had, in point of fact, been made. I endeavoured to follow as accurately as I could the very able argument of Mr. Benjamin at your Lordships' Bar on this point; but it appeared to me that this was a difficulty with which he was entirely unable to grapple. He endeavoured to contend that when the shareholders had found that something had been done by the directors which ought not to have been done, they might be authorized to make the best they could of a difficulty into which they had thus been thrown, and therefrom might be deemed to possess power to sanction the contract being proceeded with. My Lords, I am unable to adopt that suggestion. It appears to me that it would be perfectly fatal to the whole scheme of legislation to which I have referred, if you were to hold that, in the first place, directors might do that which even the whole company could not do, and that then, the shareholders finding out what had been done, could sanction, subsequently, what they could not antecedently have authorized.

My Lords, if this be the proper view of the act of Parliament, it reconciles, as it appears to me, the opinion of all the judges of the Court of Exchequer Chamber; because I find Mr. Justice BLACKBURN, whose judgment was concurred in by two other judges who took the same view, expressing himself thus (Law Rep. 9 Ex. 262): "I do not entertain any doubt that if, on the true construction of a statute creating a corporation it appears to be the intention of the

legislature, expressed or implied, that the corporation shall not enter into a particular contract, every court, whether of law or equity, is bound to treat a contract entered into contrary to the enactment as illegal, and therefore wholly void, and to hold that a contract wholly void cannot be ratified." My Lords, that sums up and exhausts the whole case. In my opinion, beyond all doubt, on the true construction of the statute of 1862, creating this corporation, it appears that it was the intention of the legislature, not implied, but actually expressed, that the corporation should not enter, having regard to its memorandum of association, into a contract of this description. If so, according to the words of Mr. Justice BLACKBURN, every court, whether of law or of equity, is bound to treat that contract, entered into contrary to the enactment, I will not say as illegal, but as *extra vires*, and wholly null and void, and to hold also that a contract wholly void cannot be ratified.

My Lords, that relieves me, and, if your Lordships agree with me, relieves your Lordships from any question with regard to ratification. I am bound to say that if ratification had to be considered I have found in this case no evidence which to my mind is at all sufficient to prove ratification; but I desire to say that I do not wish to found my opinion on any question of ratification. This contract, in my judgment, could not have been ratified by the unanimous assent of the whole corporation.

NOTE. — In earlier cases there are opinions which do not treat an *ultra vires* contract, even of a statutory corporation, as being beyond the legal capacity of the corporation. Thus Lord ST. LEONARDS in *Eastern Counties Ry. Co.* v. *Hawkes*, 5 H.L. Cas. 331 (1855), said (p. 373) he was disposed "to restrain the doctrine of *ultra vires* to clear cases of excess of power, with the knowledge of the other party, express, or implied from the nature of the corporation and of the contract entered into."

But the reasoning of Lord CAIRNS in the principal case has been accepted as settling the English law. The authorities in accord are very numerous. Nor can the corporation be held on any theory of estoppel. *Great North-West Ry. Co.* v. *Charlesbois*, [1899] A.C. 114.

If the corporation has not legal capacity to make the contract, it follows that the corporation can neither be sued, nor sue, upon it.

Torts. Suppose all the shareholders of a company authorize the directors to carry on a business in the name, with the funds and for the benefit of the corporation, and that a person employed by the directors for this purpose, while acting within the scope of his employment, commits a tort upon the plaintiff. Assuming the business is *ultra vires* of the company, can the plaintiff recover from the company? Note Lord CAIRNS's language: "It states affirmatively the ambit and extent of vitality and power which by law are given

to the corporation, and it states, if it is necessary so to state, negatively, that nothing shall be done beyond that ambit, and that no attempt shall be made to use the corporate life for any other purpose than that which is so specified." Lindley on Companies (6th ed.), pp. 213, 257: "Agents cannot have a more extensive authority than their principals can legally confer upon them; and this principle at once limits the authority of all agents of incorporated companies. The capacity of such companies is itself limited, and they cannot be legally bound by any acts of their directors or officers in which the companies themselves are legally incompetent to engage. . . . All that is necessary to charge the company [in tort] is that the act complained of should be *intra vires* and not *ultra vires*, etc." Clerk & Lindsell on Torts (6th ed.), p. 62, note (*d*): "To fix a corporation with liability for the acts of its agents, two conditions must be fulfilled; 1st, the act must have been within the scope of the agent's employment; 2nd, that employment must have been within the scope of the corporate powers." But Salmond, although formerly of this opinion (see Salmond on Torts, 2d ed., p. 56), says in his Summary of the Law of Torts, p. 43: "The rule that a corporation is not bound by contracts which are *ultra vires* is commonly said to apply also to torts which are *ultra vires*, in the sense that they are committed in the course of some activity which is beyond the limits of the corporation's powers. There is, however, no sufficient authority for any such exemption of corporations from the consequences of their disregard of the limits of their powers.". The student should consider whether (assuming that Salmond accepts the reasoning of Lord CAIRNS in the principal case as sound) he has not begged the question by speaking of "their" disregard. The fundamental question in any corporate problem is: To what acts of human beings shall corporate significance be given?

AYERS *v.* THE SOUTH AUSTRALIAN BANKING CO.

L.R. 3 P.C. 548. 1871.

THE South Australian Banking Company was incorporated by charter, which contained a clause declaring that it should not be lawful for the company to advance money on the security of merchandise. Its officers advanced its money on the security of merchandise, the lien being, in form, in favor of the corporation. Ayers, and others, withheld this merchandise from the corporation, and it brought trover.

THE LORD JUSTICE MELLISH. Another objection was taken by Mr. Manisty on the terms of the charter — the clause in the charter which says, it shall not be lawful for the bank to make advances

on merchandise. Now, unquestionably, a great many questions might be raised on the effect of that clause in the charter which may be of very great importance, but which also being of great difficulty, their Lordships do not think it necessary to give any opinion upon. There may be a question as to what are the transactions which come really within the clause, and whether this particular case does come within it. There may be also question whether, under any circumstances, the effect of violating such a provision is more than this, that the Crown may take advantage of it as a forfeiture of the charter, but the only point which it appears to their Lordships is necessary to be determined in the present case is this, that whatever effect such a clause may have, it does not prevent property passing, either in goods or in lands, under a conveyance or instrument which, under the ordinary circumstances of law, would pass it. The only defence which can be set up here (there is no plea of illegality) is under the plea of not possessed, that the right of property and the right of possession never passed to the plaintiffs. Their Lordships are of opinion, that whatever other effect it has, it cannot have the effect of preventing the property passing. If that were otherwise, the consequences might be most lamentable, because if the property never passed to them, they could not themselves convey any property to third persons. Transactions of the most honest description might be set aside. They might do what is a very common thing, make advances and take bills of exchange with the bills of lading attached. If it is to be said that the property in the goods mentioned in the bill of lading does not pass to them, then any purchaser to whom they might sell the goods under the bill of lading would get no title, and the original owner who had received the full proceeds of the goods, or a large advance upon them, might say, "Oh, the property never passed to the South Australian Bank, and, therefore, it never passed to you." Mr. Manisty admitted that he could find no authority for the proposition, that any violation of such a condition of a charter would prevent the property in goods passing to the person to whom an instrument otherwise valid professed to pass it, and their Lordships are of opinion, that whatever other effect the violation of such a condition may have, it has not the effect of preventing the property in the goods passing, or of preventing an action of trover being maintained if there is a wrongful conversion.

NOTE. — Lindley on Companies (6th ed.), p. 215, relying on this case, says: "An act or a contract which is *ultra vires* and therefore invalid is not necessarily devoid of all legal effect." The context indicates that by "legal effect" is meant "legal corporate effect." And Buckley on Companies (8th ed.), p. 17, says: "It would seem that a proprietary right belonging to a company may be enforced

and protected, even if acquired by an *ultra vires* expenditure of capital."

But the South Australian Banking Company was a chartered corporation. The student should consider whether (assuming the reasoning of Lord CAIRNS in *Ashbury Co.* v. *Riche*, *supra*, is sound) a similar result can be reached with respect to a statutory corporation. See *Davis' Case*, L.R. 12 Eq. 516; *Great Eastern Ry. Co.* v. *Turner*, L.R. 8 Ch. 149; *In re Dronfield Coal Co.*, L.R. 17 Ch.D. 76, 97; *National Telephone Co., Ltd.* v. *Constables of St. Peter Port*, [1900] A.C. 317, 321.

In re DAVID PAYNE & CO., LTD.

[1904] 2 Ch. 608.

THE directors of David Payne & Co., Limited, borrowed money by issuing a debenture in the name of the company. They intended to apply, and did apply, this money in the name of the company to accomplish an object outside the objects of the company as stated in the memorandum of association. The liquidator in the winding-up of the company applied for a declaration that the debenture was *ultra vires* and void, and did not constitute a charge on the undertaking or assets of the company.

BUCKLEY, J. [After holding that the lender, the Exploring Land and Minerals Company, had no notice of the intended misapplication.] That leaves only this matter to be considered. If an act *ultra vires* the corporation be done, it may be immaterial whether the other party to that act had knowledge or had not knowledge that the corporation could not do it, and in that state of things the investigation of knowledge which I have made would become irrelevant. Was the borrowing by David Payne & Co. for the purposes of paying 2000*l*. to Johnston and 4000*l*. to the Johnston companies *ultra vires*, so that, notwithstanding the absence of knowledge, the thing which they in fact sealed does not bind them? That arises upon a clause in the memorandum of association and one of the articles. The clause in the memorandum is a power to borrow and raise money for the purposes of the company's business, and art. 114 (D) gives power to the directors to borrow or raise or secure any sum or sums of money on the security of the property of the company by the issue of debentures, and so on. What is the effect of clauses of that kind? Suppose under a memorandum such as this a board, after passing proper resolutions, go to their bankers, or to anybody else, and say, "Lend us 10,000*l*." Is it the duty of the lending company then to say, "I look at your memorandum" — which certainly they are bound to look at — "and I find that you can only raise money for the purposes of your business; I cannot safely lend

to you until you show me you are borrowing for the purposes of your business"? In other words, is it a condition attached to the exercise of the power that the money should be borrowed for the purposes of the business, or is that a matter to be determined as between the shareholders and the directors? In my view, the introduction into any memorandum of association of a power to borrow is, generally speaking, unnecessary. Every trading company has power to borrow for the purposes of its business, and the introduction of this clause is only to express in words what would otherwise be the law. A limitation of the borrowing to borrowing for the purposes of the company's business is necessary, of course. A corporation cannot do anything except for the purposes of its business, borrowing or anything else; everything else is beyond its power, and is *ultra vires*. So that the words "for the purposes of the company's business" are a mere expression of that which would be involved if there were no such words. If you found a power to borrow which would arise only on the happening of a particular event, then I think it would lie upon the lender to say, "I cannot lend to you until you can satisfy me that the condition has been complied with"; but where the power is merely a general power to borrow, limited only, as it must be, for the purposes of the company's business, I think the matter is to be treated in this way — that the lender cannot investigate what the borrower is going to do with the money; he cannot look into the affairs of the company and say, "Your purposes do not require it now; this borrowing is unnecessary; you must show me exactly why you want it," and so on. That is all matter lying between the shareholders and the directors. If this borrowing was made, as it appears to me at present it was made, for a purpose illegitimate so far as the borrowing company was concerned, that may very well be a matter on which rights may arise as between the shareholders and directors of that company. It may have been a wrongful act on the part of the directors. But I do not think that a person who lends to the company is by any words such as these required to investigate whether the money borrowed is borrowed for a proper purpose or an improper purpose. The borrowing being effected, and the money passing to the company, the subsequent application of the money is a matter in which the directors may have acted wrongly; but that does not affect the principal act, which is the borrowing of the money. On general principles, I may point out, it would be perfectly impossible to work such a clause as this in any other way. A corporation, every time it wants to borrow, cannot be called upon by the lender to expose all its affairs, so that the lender can say, "Before I lend you anything I must investigate how you carry on your business, and I must know why you want the money, and how you apply it, and when you do have it I must see you apply it in the right way." It is perfectly impossible to work out such a principle. I think here the

power to borrow was a power resting in the directors. It did not lie on the Exploring Land and Minerals Company to say, "We cannot lend anything to you until you say exactly what you are going to do with it when you have got it."

For these reasons it seems to me the Exploring Land and Minerals Company, who have paid this money and taken this debenture without notice that the money was going to be applied as it was, are not affected by anything arising in regard to that. I therefore think that they are entitled to hold the debenture.

NOTE. — In *Norwich* v. *Norfolk Ry. Co.*, 4 E. & B. 397, Lord CAMPBELL, C.J., said (p. 443): "The mere circumstance of a covenant by directors in the name of the company being *ultra vires*, as between them and the shareholders, does not necessarily disentitle the covenantee to sue upon it. For example, if the directors of a railway company were to enter into a contract under the seal of the company for the purchase of a large quantity of iron rails and to pay for them at a fixed price, as the vendor had reasonable ground for supposing that the rails were wanted for the purpose of the railroad, it would be no defence to an action for the price, or for not accepting them, that the rails were illegally purchased on speculation, to be resold by the directors for their own profit. But suppose that the directors of a railway company should purchase a thousand gross of green spectacles, as a speculation, and should put the seal of the company to a deed covenanting to pay for these goods, here would be a clear excess of authority on the part of the directors; this excess of authority would necessarily be known to the covenantee; and, he being *in pari delicto*, I conceive that the maxim would apply *potior est conditio possidentis*. This would be an illegal contract to misapply the funds of the company; and the illegality might be set up as a defence."

But cf. *Firbank's Executors* v. *Humphreys*, L.R. 18 Q.B.D. 54.

BARONESS WENLOCK *v.* RIVER DEE CO.

L.R. 36 Ch.D. 674. 1887.

THE River Dee Company, a corporation, was empowered to borrow any sum not exceeding £25,000. A loan of a much larger sum was, in form, made by Lord Wenlock to the corporation. In an action by the executors of the lender, the company sought to defend on the ground that the loan was *ultra vires*.

LORD ESHER, M.R. In this case Lord Wenlock's executors have brought an action against the River Dee Company in order to recover a very large sum with interest upon a covenant contained in a mortgage deed, and it is undoubted that Lord Wenlock did advance a

very large sum upon a mortgage which was given to him under the seal of the company and upon a contract which those who in fact made it with him represented to be a contract with the company. The defence is, that although the money was in fact advanced upon such representation, namely, that it was money to be advanced to the company, and although the mortgage and the covenant are a mortgage and a covenant under the seal of the company, yet that the company is not liable to this action substantially in covenant, because it is alleged by the company that those who made that covenant and who made that mortgage had no authority to bind the company by the use of the seal for that purpose. If that defence be a valid one there can be no doubt about the hardship thereby inflicted upon Lord Wenlock, and in this case a hardship much greater than usual, because this is not simply the case of directors either wilfully or inadvertently doing that which, if it were upheld, would bind a number of shareholders who are not directors, but actually in this case if this covenant and this mortgage cannot be upheld it is a covenant and a mortgage made by people who are said to be the agents of the company, but who in truth and in fact are the only persons interested in the company. It is as if all the shareholders of the company were to make this representation and obtain money and then put forward the defence when an action is brought against the company, that although they, the shareholders, had misled the person into advancing his money, nevertheless the company is not liable. If this action were really the defence of those who induced Lord Wenlock to advance his money upon the representation made by them — if this action is defended in the name of the company by them — I hesitate to express the feeling which I have as to such conduct; but if this action is really defended, although in the name of the company, on behalf of the Crédit Foncier, I can pass no opinion upon whether it is a just or righteous defence or not, because I know nothing of the circumstances under which they became the persons having the command of this defence.

[After holding that the company had power to borrow £25,000 but no more.] Therefore to the extent of £25,000, but to that extent only, those who were acting for this company had power to borrow on mortgage containing a covenant, and that being so, they having borrowed money from Lord Wenlock, although they exceeded their authority when they borrowed more than £25,000, to the extent of £25,000 they did not exceed their authority, and the company is bound. Therefore Lord Wenlock, taking this to be an action on covenant, is entitled upon that covenant, and in respect of that covenant, to recover to the extent of £25,000, and the proper interest calculated in the ordinary way. But when we have to deal with the money which was obtained from Lord Wenlock on this covenant given in the name of the company and under the seal of the com-

pany, but beyond the authority of those who so borrowed the money in the name of the company, it is clear that the plaintiffs, as to that, cannot recover by action on the covenant, because the covenant is an unauthorized covenant beyond the extent of £25,000. The plaintiffs may recover in respect of some other right, but there is no right which can bind the company at law according to the common law of England, therefore their right, if any, is an equitable right. I shall not pretend to go further with regard to the equitable right than to say that if any of the money borrowed in this way from Lord Wenlock has been expended in paying proper debts of the company then, although those who received the money from Lord Wenlock were not authorized to bind the company, yet Lord Wenlock's representatives may in equity recover from the company so much of that money as was expended in paying debts of the company.

NOTE. — Affirmed in the House of Lords, L.R. 10 A.C. 354. Lord BLACKBURN said that, although he still thought his opinion in the case of *Ashbury Co.* v. *Riche* (see L.R. 9 Ex. 249) was "better than that of noble and learned lords who decided against it," he was of opinion that the law there laid down applied not only to companies formed under the Companies Act, but "to all companies created by any statute for a particular purpose."

For earlier cases, see *Troup's Case*, 29 Beav. 353; *Blackburn Society* v. *Cunliffe*, L.R. 22 Ch.D. 61; *In re Cork & Youghal Ry. Co.*, L.R. 4 Ch. 748.

The right to recover to the limited extent allowed in the principal case would seem not to depend on the absence of knowledge by the lender that the loan was *ultra vires*. See *Reversion Fund Co., Ltd.* v. *Maison Cosway, Ltd.*, [1913] 1 K.B. 364.

In *Ernest* v. *Croysdill*, 8 W.R. 736, the directors of one railway company made an unauthorized advance to a second railway company, some of the proceeds of which came into the hands of the defendant, the official manager of the second railway company. The plaintiff, who represented the first railway company, was allowed to recover the amount of such proceeds from the defendant, with interest at four per cent. from the time the defendant received them.

FURNIVALL *v.* COOMBES.

5 M. & G. 736. 1843.

A COVENANTED with C, D, E, and F, to do certain repairs to the parish church of Z; and in consideration of covenants on A's part, C, D, E, and F, "churchwardens, and overseers of the poor of the parish of Z, for themselves and for their successors, churchwardens,

and overseers of the said parish, and their assigns, did thereby covenant with A, his executors and administrators, that they, the said churchwardens and overseers of the poor, their successors or assigns, should and would well and truly pay, or cause to be paid, unto A" the sum specified, by certain instalments. After this covenant the deed proceeded as follows: "Provided always that nothing in these presents contained, shall extend, or be deemed, adjudged, construed, or taken to extend, to any *personal* covenant of, or obligation upon, the said several persons parties thereto, of the third part, or in anywise *personally* affect them, any or either of them, their, or any or either of their executors, administrators, goods, effects, or estates in their private capacity, but shall be, and is intended to be, binding and obligatory upon churchwardens and overseers of the poor of the parish of, etc., and their successors for the time being, as such churchwardens and overseers of the poor, but not further or otherwise."

TINDAL, C.J. The first question is, whether this is a personal covenant, or is it a covenant by the defendants as a corporate body. It must fall within the one class or the other. Churchwardens and overseers, though they are by statute a corporate body for some purposes, cannot enter such a covenant as this in a corporate character; and if not, then the contract must be a personal covenant. If it be, the next question is, what does it bind the defendants to do? At all events, it binds them, while they remain in office, to pay. Looking at the proviso, however, it is utterly inconsistent with the covenant. [Here, his lordship read the proviso.] Therefore, if the defendants have entered into a covenant which, to any extent, binds them personally, this proviso is at variance with such covenant, and consequently must be rejected as repugnant according to the authorities cited. . . . It would have been a different thing if the defendants had so shaped their covenant as to make the payment come only out of the parish fund.

NOTE. — In *East Anglian Rys. Co.* v. *Eastern Counties Ry. Co.*, 11 C.B. 775, JERVIS, C.J., said (p. 813): "If the contract is illegal, as being contrary to the act of Parliament, it is unnecessary to consider the effect of dissentient shareholders; for, if the company is a corporation only for a limited purpose, and a contract like that under discussion is not within their authority, the assent of all the shareholders to such a contract, though it may make them all personally liable to perform such contract, would not bind them in their corporate capacity, or render liable their corporate funds."

MacGREGOR *v.* DOVER & DEAL RY. CO.

18 Q.B. 618. 1852.

The South Eastern Railway Company was incorporated for the purpose of making and maintaining that railway, with power to raise moneys for the purposes of the act. The projectors of an intended Dover & Deal, etc., Railway had contemplated bringing a bill before Parliament for the establishment of such railway, but were in doubt as to proceeding. M, a person interested, and having influence, in the South Eastern Company, undertook that, if the projectors of the Dover, etc., Railway would proceed in endeavouring to obtain their act, and, if successful, would hand over their scheme to the South Eastern Company, that company, if the bill were rejected, would insure them against loss by such rejection, and would pay their Parliamentary expenses. No clause in the company's act empowered them so to apply their funds. The bill was proceeded with, and rejected by Parliament.

This action was brought against M for breach of this contrast.

Alderson, B. The Solicitor General argued that this promise of the defendant was in truth a promise that the South Eastern Railway Company should do an illegal thing, and that the promise was therefore void: and we are of that opinion. This is not like the promise of a party that an act impossible to be done shall be done by the defendant or by some third person; but it is a promise that an act shall be done contrary to the public law of the country, of which both parties are bound to take notice. The act is therefore illegal; and the promise that it shall be done is a void promise.

The question is, we think, determined by the decision of the Court of Common Pleas in *East Anglian Railways Company* v. *Eastern Counties Railway Company*, 11 Com. B. 775. It is there laid down that a railway company incorporated by act of Parliament is bound to apply all the funds of the company for the purposes directed and provided for by the act, and for no other purpose whatsoever; and then, the defendants having, *inter alia*, covenanted to pay the costs of soliciting bills then pending in Parliament, it was held that the act incorporating the defendants, being a public act, must be presumed to be known to the plaintiffs, and that they could not recover, inasmuch as the covenant entered into by the defendants was beyond the scope of their authority as a corporation, and was therefore illegal and void. The court there say that such a contract is illegal, because it is contrary to the act of Parliament which was passed to give them certain powers as a corporation for public purposes of advantage to the country at large as well as for the private profit of the individual members of the corporation; and they add

that the actual assent of the whole body of shareholders would make no real difference in the matter.

If this be so, both plaintiffs and defendant here must be taken, with full knowledge of the powers conferred on the South Eastern Railway Company, to have made a contract by which the defendant is to bind the company to do an illegal act; not merely an act which they have no power to do, but an act contrary to public policy and the provisions of a public act of Parliament. This, we think, is a void contract, and one, therefore, which cannot form the proper ground for a suit in a court of law.

RICHARDSON *v.* WILLIAMSON.

L.R. 6 Q.B. 276. 1871.

Declaration on the common money counts.

Plea: never indebted. Issue joined.

At the trial before Hannen, J., at the London sittings after Easter term, 1870, it appeared that the action was brought to recover 50*l.*, the balance of 70*l.*, which the plaintiff had lent to The Imperial Permanent Benefit Building Society, on the deposit of which she received the following document, stamped as a receipt, signed by the two defendants, who were directors of the society: —

"Imperial Permanent Benefit Building Society,
"London, 17th June, 1867.

"This is to certify that Mrs. A. E. Richardson, of, etc., has this day deposited the sum of 70*l.* with the Imperial Permanent Benefit Building Society for a period of three months certain, upon which interest at the rate of 5*l.* per cent. per annum will be allowed.

"J. W. Williamson, }
"C. L. Lawson, } Directors.

"Wm. Richardson, Secretary.

"Memorandum. — The above deposit may be withdrawn at any time subsequent to 17th Sept., 1867, upon receipt of fourteen days previous notice of such intended withdrawal."

The plaintiff withdrew 20*l.* on the 7th of May, 1868, and after giving notice to withdraw the rest, she was unable to obtain it; and a correspondence ensued, in which the defendants said there were plenty of funds, but not immediately available. Being unable to get her money, the plaintiff took legal advice, and was advised that she had no remedy against the society, which was established under the Benefit Building Societies Act (6 & 7 Wm. 4, chap. 32), and the rules of the society containing no power to borrow money; she accordingly brought the present action, seeking to make the defendants personally liable.

Cockburn, C.J. The defendants as directors appear to have proceeded to borrow money on behalf of the society without ascertaining whether they had power to do so, and they apply to the public to advance money on the faith of the solvency and liability of the society. It turns out that they had no authority to do this, the society having no power to borrow money. It cannot be supposed that the plaintiff on lending money to the society did so with the knowledge that the society was not authorized to borrow; and it was not till she wanted her money back that she ascertained the real position of affairs, and is met by the defence that the society is not liable. Fortunately, there is a mode by which persons acting as the defendants have done can be reached, and the loss thrown on the right parties. By the law of England, persons who induce others to act on the supposition that they have authority to enter into a binding contract on behalf of third persons, on it turning out that they have no such authority, may be sued for damages for the breach of an implied warranty of authority. This was decided in *Collen* v. *Wright*, 7 E. & B. 301 (E. C. L. R. vol. 90), 26 L.J. (Q.B.) 147, 8 E. & B. 647 (E. C. L. R. vol. 92), 27 L.J. (Q.B.) 215, and other cases; and the necessary amendment may be made in the present case. Then I think upon the facts the inference is, that the defendants do represent upon this instrument that they are authorized on behalf of the society to borrow money, and that the society will be liable on this contract of loan. It is quite true, as the defendants' counsel contended, that the plaintiff intended to deal with the society; and the ground of the amended cause of action is that the defendants induced her to deal with the society by representing they had authority when they had not.

Blackburn, J. I am of the same opinion. It appears that the plaintiff on advancing her money received a certificate, signed by two directors, that she had deposited the money with the society for three months, and that after that it would be repaid with interest after fourteen days notice. I think it clear that the defendants, the two directors who signed this certificate, did by that represent that they had authority to borrow the money on behalf of the society, and that the society would be bound to repay it on proper demand. As they had no such authority, it follows, on the principle of the decision in *Collen* v. *Wright*, that the plaintiff is entitled to recover from the defendants the damages she has suffered from not being able to sue the society, on showing that the defendants professed to be able to bind the society. But as the declaration only contains the common money counts, it will be necessary that an amendment should be made. Had the society been insolvent, the damages would have been possibly nil. The correspondence shows that the society has ample funds, and, therefore, the damages will be the same as what she would have recovered from

the society had it been liable, that is, the amount of her loan and interest.

NOTE. — The Imperial Permanent Benefit Building Society was an unincorporated society. See 6 & 7 Wm. 4, c. 32, and 10 Geo. 4, c. 56. Under 10 Geo. 4, c. 56, the members of such a society were to adopt Rules setting forth, among other things the "Purposes for which such society is intended to be established" (section III), and a transcript of these Rules was to be filed in a specified public office (section IV).

In *Beattie* v. *Lord Ebury*, L.R. 7 Ch. 777, MELLISH, L.J., said (p. 800): "I have no doubt myself that it would be held that if there is no misrepresentation in point of fact, but merely a mistake or misrepresentation in point of law, that is to say, if the person who deals with the agent is fully aware in point of fact what the extent of the authority of the agent is to bind his principal, but makes a mistake as to whether that authority is sufficient in point of law or not, under those circumstances I have no doubt that the agent would not be liable. For instance, supposing when an agent comes and professes to make a contract on behalf of his principal, instead of trusting his representation that he has power to bind his principal the person dealing with the agent were to ask to see his authority, and a power of attorney executed by the principal was shewn to him, and he took the opinion of his lawyer as to whether the power of attorney was sufficient to bind the principal, and was advised that it was sufficient to bind the principal, and then after that a contract was made, and it turned out when the point was raised in a Court of Law that the power of attorney was insufficient — under such circumstances I am clearly of opinion that there would be no warranty on the part of the agent that the power of attorney was good in point of law. The first case mentioned on the subject was *Collen* v. *Wright*, 8 E. & B. 647. That was a simple case, where the steward of a gentleman executed an agreement for a lease in his name, and when a suit was brought for specific performance it turned out that the gentleman had never given any authority to the steward to make an agreement for a lease in his name. Specific performance was therefore refused. The plaintiff then brought an action against the steward to recover damages, and was held entitled to recover. There it is perfectly plain that the defendant had made a misrepresentation in point of fact.

"The next case was the case of *Richardson* v. *Williamson*, Law Rep. 6 Q.B. 276. There the plaintiff lent £70 to a benefit building society, and received a receipt signed by the defendants, as two of the directors, certifying that the money had been lent, and then it turned out that in point of law they had no power to borrow money. But, then, their power to borrow money depended upon whether they

had made a rule to borrow money, because a benefit building society may receive money, at any rate to a certain amount, on deposit, if it has a rule enabling it so to receive money. Therefore that was taken as a representation by the directors that they had such a rule, and that the borrowing was within the rule when, in point of fact, there was no such rule at all." See also *Rashdall* v. *Ford*, L.R. 2 Eq. 750.

In *Riche* v. *Ashbury Co.*, L.R. 9 Exch. 224, MARTIN, B., said (p. 249): "That the directors would be liable upon the contracts sued on there can be no doubt."

For cases in which the plaintiff had no means of knowing that the corporation had no power to make the contract, and in which the court was of opinion that the corporation was not liable, and that the directors were liable see *Firbank* v. *Humphreys*, L.R. 18 Q.B. 54; *Weeks* v. *Propert*, L.R. 8 C.P. 427. See also *Higgins* v. *Livingstone*, 4 Dow, 341, 355.

SECTION 2.

UNITED STATES AUTHORITIES.

A. Torts.

NIMS *v.* MOUNT HERMON BOYS' SCHOOL.

160 Mass. 177. 1893.

KNOWLTON, J. The defendant is an educational corporation. The plaintiff seeks to recover damages for an injury received through the negligence of a ferryman in managing a boat on which he was a passenger, and which, as he alleges, the defendant was using at a public ferry in the business of carrying passengers for hire. At the request of the defendant, the presiding justice ruled that there was no evidence to warrant a finding for the plaintiff, and directed a verdict for the defendant. The defendant contends that the ruling should be sustained on one or both of two grounds. It says in the first place, that, if it maintained the ferry and hired and paid the ferryman, the business was *ultra vires*, and therefore it is not liable for negligence in the management of the boat. Secondly, it contends that there was no evidence to connect the corporation with the business of running the ferry-boat, or to show that the ferryman was its servant.

It is a general rule that corporations are liable for their torts as natural persons are. It is no defence to an action for a tort to show that the corporation is not authorized by its charter to do wrong. Recovery may be had against corporations for assault and battery, for libel and for malicious prosecution, as well as for torts resulting from negligent management of the corporate business. *Moore* v. *Fitchburg Railroad*, 4 Gray, 465; *Reed* v. *Home Savings Bank*, 130 Mass. 443; *Fogg* v. *Boston & Lowell Railroad*, 148 Mass. 513; *Philadelphia, Wilmington, & Baltimore Railroad* v. *Quigley*, 21 How. 202, 209; *Merchants' Bank* v. *State Bank*, 10 Wall. 604; *National Bank* v. *Graham*, 100 U.S. 699; *Gruber* v. *Washington & Jamesville Railroad*, 92 N.C. 1; *Hussey* v. *Norfolk Southern Railroad*, 98 N.C. 34. If a corporation by its officers or agents unlawfully injures a person, whether intentionally or negligently, it would be most unjust to allow it to escape responsibility on the ground that its act is *ultra vires*. The only plausible ground on which the defendant in the present case can contend that it should be exempt from liability for the negligence of its servant in managing the ferry-boat is that the

contract to carry the plaintiff was *ultra vires*, and therefore invalid, and that the duty for neglect of which the plaintiff sues arose out of the contract, and disappears with it when the contract appears to be void. The defendant may argue that the plaintiff cannot maintain an action for a breach of the contract to use proper care to carry him safely, and that he stands no better when he sues in tort for failure to do the duty which grew out of the contract.

In *Bissell* v. *Michigan Southern & Northern Indiana Railroad*, 22 N.Y. 258, the plaintiff founded his action on the negligence of the two defendants while jointly running cars on a railroad in a State to which the charter of neither of them extended, and it was conceded that the defendants were acting *ultra vires*. The plaintiff recovered, COMSTOCK, C.J., holding in an elaborate opinion that the corporations were liable under their contract, notwithstanding that the contract was *ultra vires*, and that if they could not be held under their contract they could not be held at all, inasmuch as the only negligence alleged was a failure to use the care which the contract called for. SELDEN, J., in an equally full and elaborate opinion, held that the contract for carriage was invalid, and that there could be no recovery under it, nor for negligence founded upon it; but it was his opinion that, if the contract were set aside, the defendants owed the plaintiff a duty founded on his relation to them as an occupant, with their permission, of a place in their car, and that the improper management of the car was a neglect of that duty for which the plaintiff could recover. CLERKE, J., agreed with this view, and all but one of the other judges concurred in a decision for the plaintiff, without stating the ground on which they thought the decision should be placed. This case was followed in *Buffett* v. *Troy & Boston Railroad*, 40 N.Y. 168, in which it was held that a railroad corporation was liable for negligence of the driver of a stage-coach which it was running without a legal right to do a business of that kind; but the opinion does not show whether the decision is founded on the opinion of COMSTOCK, C.J., given in the former case, or on that of SELDEN, J. Like decisions have been made under similar facts in *Central Railroad & Banking Co.* v. *Smith*, 76 Ala. 572; *New York, Lake Erie, & Western Railway* v. *Haring*, 18 Vroom, 137; and *Hutchinson* v. *Western & Atlantic Railroad*, 6 Heisk, 634.

In the present case we think it makes no difference that the defendant was not a manufacturing or trading corporation, but was chartered for educational purposes only. It could acquire and hold property, make contracts, and do anything else incidental to the maintenance of the school. Doubtless some of its officers or agents thought it would be an advantage to its students and managers to have a public ferry at the place where the plaintiff was injured. Its maintenance of such a ferry was *ultra vires*, but its acts in that respect were not different in kind from the ordinary acts of corpora-

tions in excess of the powers given them by their charter. We are of opinion, therefore, that if the defendant while running the ferry-boat accepted the plaintiff as a passenger to be transported for hire, and undertook to carry him across the river, he was in the boat as a licensee, it owed him the duty to use proper care to carry him safely, and, whether an action could be maintained for a breach of the contract or not, it is liable to the plaintiff in an action of tort for neglect of that duty.

The other question in the case is whether there was evidence that the corporation operated the ferry. Under its by-laws the management of the corporation is vested in a board of trustees. It does not appear that any vote was ever taken in regard to the ferry, and it was not shown that any officer of the corporation took out the license which was granted to the defendant by the county commissioners, under Pub. Sts. chap. 55, § 1, to keep the ferry, but the records of the county commissioners show that such a license was granted, and that a bond with sureties was given to the county of Franklin, with the condition properly to perform the duty of a ferryman, executed in behalf of the defendant by one who was designated as superintendent, and witnessed by the defendant's cashier and paymaster. It further appeared that the title to the property used at the ferry was taken by Ambert G. Moody, one of the trustees of the defendant, who was then a student in Amherst College, and that he paid for it only a nominal sum above the mortgage existing upon it, and that he and the defendant's superintendent, who had charge of its farm, employed one Deane to operate the ferry, who was paid by the month, and who turned over the balance of the receipts of the ferry above his wages to the defendant's cashier and paymaster. For the month of April Deane was paid for his services by the defendant's paymaster out of the defendant's funds. In June, 1890, a new ferry-boat was constructed under an arrangement with Ambert G. Moody and Dwight L. Moody, both of whom were trustees of the corporation, and was paid for by the paymaster out of the funds of the corporation. For six months, and until there was a change in the management of the ferry, the defendant's cashier and paymaster sent to the treasurer, who lived in New York, monthly accounts, showing monthly receipts and expenses on account of the ferry. Accompanying the first of these accounts was a statement that the school was running the ferry and paying the bills. The treasurer was himself a trustee of the corporation. He subsequently rendered his official report to the corporation, which was audited by another of the trustees, who did not examine the items in person, but caused the examination to be made by a man in his employment. This report was accepted by the trustees and placed on file. The items of receipts and expenditures were entered on the books of the treasurer in an account under the title "ferry." The treasurer's

report was not put in evidence, and was not produced, although the defendant was notified to produce it.

There is no evidence of original authority from the defendant to anybody to operate the ferry on its account, but the evidence is plenary that persons connected with the management of its business assumed so to operate it. The important question is whether there was evidence that the corporation ratified the acts of these persons. We are of opinion that there was evidence from which the jury might have found such ratification. It is not necessary that the ratification should be by a formal vote. It is enough if the corporation, acting through its managing officers, knowing that the business had been done by those who assumed to act as its agents in doing it, and that the income of the business had been received and the expenses of it paid by its treasurer in his official capacity, and that the balance of the receipts above the expenditures was in its treasury, adopted the action of its treasurer, and elected to keep the money. It was a fair inference of fact, especially when the corporation failed to produce the treasurer's report after notice to produce it, that the report contained a true statement of the accounts which related to the ferry, and that it was accepted with full knowledge on the part of the trustees of what it contained. Whether there was a ratification by the corporation was a question of fact for the jury on all the evidence.

If there was such a ratification, it carried with it the consequences which would have followed an original authority. In *Dempsey* v. *Chambers*, 154 Mass. 330, it was held, after much consideration, that ratification of an unauthorized act would make the principal liable in an action of tort for an injury resulting from negligence of the agent in doing the act.

We are of opinion that the case should have been submitted to the jury.

Exceptions sustained.

NOTE. — A corporation may be liable for tort committed in the course of an *ultra vires* undertaking, *South & North Alabama R.R. Co.* v. *Chappell*, 61 Ala. 527; *First National Bank* v. *Henry*, 159 Ala. 367; *First National Bank* v. *Strang*, 138 Ill. 347, 356; *Feital* v. *Middlesex R.R. Co.*, 109 Mass. 398; *Alexander* v. *Relfe*, 74 Mo. 495, 517; *New York, Lake Erie & Western Ry. Co.* v. *Haring*, 47 N.J.L. 137; *Bissell* v. *Michigan Southern*, 22 N.Y. 258; *Buffett* v. *Troy & Boston R.R. Co.*, 40 N.Y. 168; *Hannon* v. *Siegel-Cooper Co.*, 167 N.Y. 244 (a corporation, proprietor of a department store, held liable for malpractice in the business of dentistry. "Though it was beyond the corporate powers of the defendant to engage in the business this does not relieve it from the torts of its servants committed therein"); *Gruber* v. *Railroad Co.*, 92 N.C. 1; *Searle* v. *First National Bank*, 2

Walker (Pa.) 395; *Hutchinson* v. *Western R.R. Co.*, 6 Heisk. (Tenn.) 634; *Zinc Carbonate Co.* v. *First National Bank*, 103 Wis. 125; *National Bank* v. *Graham*, 100 U.S. 699 ("corporations are liable for every wrong they commit, and in such cases the doctrine of *ultra vires* has no application"). But see, *contra*, *Gunn* v. *Central R.R.*, 74 Ga. 509; *Bathe* v. *Decatur Agricultural Society*, 73 Iowa, 11; *Weckler* v. *First National Bank*, 42 Md. 581, 595.

Salt Lake City v. *Hollister*, 118 U.S. 256. The question was whether a municipal corporation was subject to internal revenue taxation under the laws of the United States for engaging in the business of distilling spirits: The defense was that it was *ultra vires* for the corporation to engage in such a business. The court held that the corporation was liable. Mr. Justice MILLER said (p. 259): "It would be a fine thing, if this argument is good, for all distillers to organize into milling corporations to make flour, and proceed to the more profitable business of distilling spirits, which would be unauthorized by their charters or articles of incorporation; for they would thus escape taxation and ruin all competitors. It is said that the acts done are not the acts of the city, but of its officers or agents who undertook to do them in its name. This would be a pleasant farce to be enacted by irresponsible parties, who give no bond, who have no property to respond to civil or criminal suits, who make no profit out of it, while the city grows rich in the performance. It is to be taken as a fair inference on this demurrer that all that the city might have done was done in establishing this business. The officers who, it is said, did this thing, must be supposed to have been properly appointed or elected. Resolutions or ordinances of the governing body of the city directing the establishment of the distillery and furnishing money to buy the plant, must be supposed to have been passed in the usual mode. Everything must have been done under the same rules and by the same men as if it were a hospital or a town hall. If the demurrer had not admitted this, it could no doubt have been proved on an issue denying it. But the argument is unsound that whatever is done by a corporation in excess of the corporate powers, as defined by its charter, is as though it was not done at all. A railroad company authorized to acquire a right of way by such exercise of the right of eminent domain as the law prescribes, which undertakes to and does seize upon and invade, by its officers and servants, the land of a citizen, makes no compensation, and takes no steps for the appropriation of it, is a naked trespasser, and can be made responsible for the tort. It had no authority to take the man's land or to invade his premises. But if the governing board had directed the act, the corporation could be sued for the tort, in an action of ejectment, or in trespass, or on an implied assumpsit for the value of the land. A plea of *ultra vires*, in this case, would be no defence. The truth is, that, with the great increase in corpora-

tions in very recent times, and in their extension to nearly all the business transactions of life, it has been found necessary to hold them responsible for acts not strictly within their corporate powers, but done in their corporate name, and by corporation officers who were competent to exercise all the corporate powers. When such acts are not founded on contract, but are arbitrary exercises of power in the nature of torts, or are quasi-criminal, the corporation may be held to a pecuniary responsibility for them to the party injured."

CENTRAL R.R. CO. *v.* SMITH.

76 Ala. 572. 1884.

APPEAL from Circuit Court.

Action by Smith against the appellant, described as "a corporation created by the laws of Georgia, and doing business in Alabama by agents." Plaintiff seeks to recover damages for injuries sustained by the sinking of the steamboat *George W. Wylly*, while running on the Chattahoochee River; the plaintiff having been a passenger at the time.

The complaint alleged that the defendant corporation was a common carrier, and was, in connection with one Whitesides (who was not sued), the owner and proprietor of said steamboat, and engaged in running and operating it for the transportation of passengers and freight for a reward; and that the accident and injury were caused by the negligence of the officers and persons in charge of the boat, and its unsound and rotten condition. The defendant pleaded not guilty, and a special plea which averred, in substance, that it had no authority under its charter to engage in running a steamboat on the Chattahoochee River, and that the persons who were engaged in running said steamboat, at the time of the alleged loss and injury, were not the agents or servants of said defendant. Issue was joined on both of these pleas.

The court, at defendant's request, instructed the jury that the defendant had no power under its charter to own or operate the steamboat. The court, however, at plaintiff's request, added to this instruction: "But this will not excuse defendants, if the evidence shows they did operate it." To this addition, defendant excepted.

CLOPTON, J. [The court held, on other grounds, that there must be a new trial. It further held that the corporation had no power, under its charter, to own and operate the steamboat in association with a natural person.] The question is, what is the liability of a corporation for a tort, committed while transacting a business without and beyond the purview of the corporate powers and purposes? This is

followed by another question; by what authority, and in what manner, can a corporation be subjected to such liability? . . .

Before the duties and responsibilities attach, the corporation must undertake and engage in the business, and thereby assume its burdens. Of this there can be no implication, from the isolated fact, that some officer or agent has engaged, in the name of the company, in running and operating the boats; in other words, there can be no implication that a corporation has made a contract, or engaged in business transcending its powers. Green's Brice's Ultra Vires, 364. It may be inferred from proved circumstances, as other facts, but is not the subject of implication. Corporations are responsible for the wrongs committed by their officers, agents, or servants, while in the course of their employment; but, if the officer, agent, or servant, "go beyond the range of his employment or duties, and of his own will do an unlawful act injurious to another, the agent is liable, but the master or employer is not." *Gilliam* v. *S. & N. R.R. Co.*, 70 Ala. 268. The limitation is, the scope of the employment, or delegated authority. If an officer or agent can not directly subject the corporation to liability for his tortious act beyond the range and course of his employment, though done while engaged in its performance, for what reason, or on what principle is it, that an officer or agent can, by making an unlawful transaction, and engaging in an unauthorized and unlawful business, in the name of the company, without the authority of the corporation, indirectly subject it to liability for the negligent or intentional wrongs of the agents or servants employed by him in the performance of such contract, or in carrying on such business? While corporations should be held to a strict responsibility for the wrongful acts of their employees, when done in the course of their employment, and connected with the execution of the business for which incorporated, they should be protected against the consequences of unauthorized acts of their officers or agents, committed in excess of its powers, and unconnected with the business or purposes of their incorporation and organization, especially when dealing with persons charged with notice of their powers, and the nature and extent of the employment and authority of the officer or agent.

In *Brakan* v. *N.J. R. & T. Co.*, 32 N.J. Law, 328, it is said: "In considering the question whether the agent has the authority of the corporation, so as to make it answerable for his act, the purposes for which the company was incorporated must not be overlooked. An authority given even by the board of directors, in express terms, will not, in all cases, be the authority of the corporation. The directors are only agents themselves, and their powers are necessarily limited within the scope of the purposes for which the corporation was created, beyond which they are not authorized to bind the corporation. To fix the liability of a corporation for the tortious

acts of one of its employees done in obedience to the commands of its officers, the act must be connected with the transaction of the business for which the company was incorporated. If the directors should order an agent to take a person out of his house and beat him; or if the directors of a banking company should purchase a steamboat, and engage in transporting passengers, the corporation would not be liable for the misfeasance or nonfeasance of agents employed in that business." It is true that the board of directors may be invested by the charter, or general law, with such management and authority as practically to constitute it the corporation; but, by the provisions of the charter of the defendants, the directors are agents and representatives, with authority limited by the scope of the powers, business, and purposes of the corporation. It will be observed that the business was not carried on in the name of the corporation. As there is no implied authority of any officer or agent to make an *ultra vires* contract, or transaction, and on that ground merely bind the corporation, it follows, that if the boats were purchased and engaged, in connection with Whitesides, in the business of transporting persons and freight on the Chattahoochee River, by the president, superintendent, or even the directors, the corporation is not bound thereby, and is not liable for the negligent or wrongful acts of the persons employed in such business, unless the transaction was previously authorized, or subsequently ratified by the corporation. Without such authority or ratification, the persons thus employed are not the agents or employees of the corporation. As the immediate or direct act of the officer or agent, in such case, can not bind the corporation, his mere knowledge of, and acquiescence in the prosecution of such business, are not tantamount to a ratification by the corporation. Considering the difference between the principles which govern the liability of the company for the tortious acts of its agents committed in the course of their authorized employment, and its liability for the tortious acts of persons employed in the conduct and prosecution of a business undertaken on behalf of the corporation by its agents, beyond the range of their employment, and prohibited by the laws of its creation, the previous authority or subsequent ratification, in order to bind the corporation, must be in corporate capacity.

A corporation is an artificial body, a distinct person, in legal contemplation, from the stockholders, in which the corporate property is vested. Its will is usually or ordinarily expressed at a meeting of the corporators. Its officers are its agents, and not the agents of the stockholders. In this sense, previous authority, to bind the corporation by the act of an officer or agent transcending its powers and unconnected with its authorized business and purposes, must be the result of corporate action, as contradistinguished from the individual action of the stockholders or officers. Subse-

quent ratification results, when a knowledge of the business being thus conducted, and of the reception and retention of its fruits and benefits, is brought home to the corporators, at a time, and under circumstances which require them to elect to repudiate or be bound, and they fail to disavow the act; in other words, any facts, which would be a ratification of the unauthorized acts of an agent by a principal who is a natural person.

NOTE. — The *Mount Hermon Boys' School* was an educational corporation, and it does not appear that there were any stockholders. In the case of a corporation having stockholders, will the act of the directors (or other similar managing officers) in engaging, in the name of the corporation, in a business, lawful in itself but *ultra vires* of the corporation, be given corporate significance, without more? This is not as yet plain under the authorities.

In most of the cases cited in the note to *Nims* v. *Mount Hermon Boys' School*, *supra*, no consideration was given to this question. In the *Bissell* case, SELDEN, J., said (22 N.Y. 258, 306): "There is no doubt that all that was done under the arrangement between the defendants, unauthorized and contrary to law, is nevertheless to be treated as done by the corporations themselves. The business was carried on under the direction of their managing officers, with their property and for their benefit, and they cannot now be heard to deny that it was done by them." It is to be noted, however, that the business there in question had been carried on openly in the name of the corporation over a considerable period of time.

B. Transfers of Property Rights.

NATIONAL BANK *v.* MATTHEWS.

98 U.S. 621. 1878.

ERROR to the Supreme Court of the State of Missouri.

On the 1st of March, 1871, Hugh B. Logan and Elizabeth A. Matthews executed and delivered to Sterling Price & Co. their joint and several promissory note for the sum of $15,000, payable to the order of that firm two years from date, with interest at the rate of ten per cent per annum. The payment of the note was secured by a deed of trust, executed by her, of certain real estate therein described, situate in the State of Missouri.

On the 13th of the same month, the note and deed of trust were assigned to the Union National Bank of St. Louis. Price & Co. failed to pay the loan at maturity. The bank directed the trustee named in the deed of trust to sell. Said Elizabeth thereupon filed this bill in the proper State court to enjoin the sale. The bank in its answer avers that it "accepted the said note and deed of trust as security for the sum of $15,000, then and there advanced and loaned to said Sterling Price & Co. . . . on the security of said note and deed of trust." A perpetual injunction was decreed, upon the ground that the loan by the bank to Price & Co. was made upon real-estate security; that it was forbidden by law; and that the deed of trust was, therefore, void. The decree was made upon the pleadings. No testimony was introduced upon either side. The bank removed the case to the Supreme Court of the State, where the decree was affirmed. The bank then sued out this writ of error.

MR. JUSTICE SWAYNE, after stating the facts, delivered the opinion of the court.

This case involves a question arising under the national banking law, which has not heretofore been passed upon by this court. We have considered it with the care due to its importance.

Our attention has been called to but a single point which requires consideration, and that is, whether the deed of trust can be enforced for the benefit of the bank.

The statutory provisions which bear upon the subject are as follows: —

"SECT. 5136." Every national banking association is authorized "to exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences

of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this title.

"SECT. 5137. A national banking association may purchase, hold, and convey real estate for the following purposes, and for no others: *First*, such as may be necessary for its immediate accommodation in the transaction of its business. *Second*, such as shall be mortgaged to it in good faith by way of security for debts previously contracted. *Third*, such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings. *Fourth*, such as it shall purchase at sales under judgments, decrees, or mortgages held by the association, or shall purchase to secure debts to it. But no such association shall hold the possession of any real estate under mortgage, or the title and possession of any real estate purchased to secure any debts due to it for a longer period than five years." Rev. Stat. 1999; 13 Stat. 99.

Here the bank never had any title, legal or equitable, to the real estate in question. It may acquire a title by purchasing at a sale under the deed of trust; but that has not yet occurred, and never may.

Section 5137 has, therefore, no direct application to the case. It is only material as throwing light upon the point to be considered in the preceding section. Except for that purpose it may be laid out of view.

Section 5136 does not, in terms, prohibit a loan on real estate, but the implication to that effect is clear. What is so implied is as effectual as if it were expressed. As the transaction is disclosed in the record, the loan was made upon the note as well as the deed of trust. *Non constat*, that the maker who executed the deed would not have been deemed abundantly sufficient without the further security. The deed, as a mortgage would have been, was an incident to the note and a right to the benefit of the deed, whether mentioned or delivered or not, when the note was assigned, would have passed with the note to the transferee of the latter.

The object of the restrictions was obviously threefold. It was to keep the capital of the banks flowing in the daily channels of commerce; to deter them from embarking in hazardous real-estate speculations; and to prevent the accumulation of large masses of such property in their hands, to be held, as it were, in mortmain. The intent, not the letter, of the statute constitutes the law. A court of equity is always reluctant in the last degree to make a decree which will effect a forfeiture. The bank parted with its money in good faith. Its garments are unspotted. Under these circumstances, the defence of *ultra vires*, if it can be made, does not address itself favorably to the mind of the Chancellor. We find nothing in the record

touching the deed of trust which, in our judgment, brings it within the letter or the meaning of the prohibitions relied upon by the counsel for the defendant in error.

Where a corporation is incompetent by its charter to take a title to real estate, a conveyance to it is not void, but only voidable, and the sovereign alone can object. It is valid until assailed in a direct proceeding instituted for that purpose. *Leazure* v. *Hillegas*, 7 Serg. & R. (Pa.) 313; *Goundie* v. *Northampton Water Co.*, 7 Pa. St. 233; *Runyon* v. *Coster*, 14 Pet. 122; *The Banks* v. *Poitiaux*, 3 Rand. (Va.) 136; *McIndoe* v. *The City of St. Louis*, 10 Mo. 577. See also *Gold Mining Company* v. *National Bank*, 96 U.S. 640.

The authority first cited is elaborate and exhaustive upon the subject. So an alien, forbidden by the local law to acquire real estate, may take and hold title until office found. *Fairfax's Devisee* v. *Hunter's Lessee*, 7 Cranch, 604.

In *Silver Lake Bank* v. *North*, 4 Johns. (N.Y.) Ch. 370, the bank was a Pennsylvania corporation, and had taken a mortgage upon real estate in New York. A bill of foreclosure was filed in the latter State. The answer set up as a defence "that by the act of incorporation the plaintiffs were not authorized to take a mortgage except to secure a debt previously contracted in the course of its dealings; and here the money was lent after the bond and mortgage were executed." The analogy of this defence to the one we are considering is too obvious to need remark. Both present exactly the same question. Chancellor KENT said: "Perhaps it would be sufficient for this case that the plaintiffs are a duly incorporated body, with authority to contract and take mortgages and judgments; and if they should pass the exact line of their power, it would rather belong to the government of Pennsylvania to exact a forfeiture of their charter, than for this court in this collateral way to decide a question of misuser, by setting aside a just and *bona fide* contract. . . . If the loan and mortgage were concurrent acts, and intended so to be, it was not a case within the reason and spirit of the restraining clause of the statute, which only meant to prohibit the banking company from vesting their capital in real property, and engaging in land speculations. A mortgage taken to secure a loan advanced *bona fide* as a loan, in the course and according to the usage of banking operations, is not surely within the prohibition."

It is not denied that the loan here in question was within this category. This authority, if recognized as sound, is conclusive. See also *Baird* v. *The Bank of Washington*, 11 Serg. & R. (Pa.) 411.

Sedgwick (Stat. and Const. Constr. 73) says: "Where it is a simple question of authority to contract, arising either on a question of regularity of organization or of power conferred by the charter, a party who has had the benefit of the agreement cannot be permitted in an action founded upon it to question its validity. It would be in the

highest degree inequitable and unjust to permit a defendant to repudiate a contract, the benefit of which he retains."

What is said in the text is fully sustained by the authorities cited.

We cannot believe it was meant that stockholders, and perhaps depositors and other creditors, should be punished and the borrower rewarded, by giving success to this defence whenever the offensive fact shall occur. The impending danger of a judgment of ouster and dissolution was, we think, the check, and none other contemplated by Congress.

That has been always the punishment prescribed for the wanton violation of a charter, and it may be made to follow whenever the proper public authority shall see fit to invoke its application. A private person cannot, directly or indirectly, usurp this function of the government.

The decree of the Supreme Court of Missouri will be reversed, and the cause remanded with directions to dismiss the bill; and it is

So ordered.

MR. JUSTICE MILLER dissenting.

I am of opinion that the National Banking Act makes void every mortgage or other conveyance of land as a security for money loaned by the bank at the time of the transaction to whomsoever the conveyance may be made; that the bank is forbidden to accept such security, and it is void in its hands.

The contract to pay the money, and the collateral conveyance for security, are separable contracts, and so far independent that one may stand and the other fall.

In the present case, the money was loaned on the faith of the deed of trust, and that instrument is void in the hands of the bank, but the note, as evidence of the loan of money, is valid against Mrs. Matthews personally. With this latter contract the State court did not interfere. It enjoined proceedings under the deed of trust against the land, and did no more.

Its judgment in that matter ought, in my opinion, to be affirmed.

KERFOOT *v.* FARMERS' BANK.

218 U.S. 281. 1910.

MR. JUSTICE HUGHES delivered the opinion of the court.

This action was brought in 1894, in the Circuit Court of Grundy County, State of Missouri, to set aside a deed of real property made by James H. Kerfoot to the First National Bank of Trenton, Missouri, and also a deed by which that bank purported to convey the

same property to the defendants Hervey Kerfoot, Alwilda Kerfoot and Lester R. Kerfoot, and for the recovery of possession. The plaintiffs in the action, which was brought shortly after the death of James H. Kerfoot, were Homer Hall, administrator of his estate, and Robert Earl Kerfoot, his infant grandson, who claimed to be his only heir at law and sued by Homer Hall as next friend. The petition contained two counts, one in equity, the other in ejectment. Upon the trial the Circuit Court found the issues for defendants and the judgment in their favor was affirmed by the Supreme Court of Missouri. 145 Missouri, 418. On his coming of age Robert Earl Kerfoot sued out this writ of error.

The plaintiff in error challenges the conveyance made by James H. Kerfoot to the bank, upon the ground that under § 5137 of the Revised Statutes of the United States, relating to national banks, the bank was without power to take property, and hence that no title passed by the deed, but that it remained in the grantor and descended to the plaintiff in error as his heir at law. It appears that the deed, which was absolute in form, with warranty and expressing a substantial consideration, was executed in pursuance of an arrangement by which the title to the property was to be held in trust to be conveyed upon the direction of the grantor; and the Supreme Court of Missouri decided that a trust was in fact declared by the grantor in favor of Hervey, Alwilda and Lester R. Kerfoot, to whom ran a quitclaim deed, which he prepared and forwarded to the bank to be signed and acknowledged by it and then returned to him.

But while the purpose of this transaction was not one of those described in the statute for which a national bank may purchase and hold real estate, it does not follow that the deed was a nullity and that it failed to convey title to the property.

In the absence of a clear expression of legislative intention to the contrary, a conveyance of real estate to a corporation for a purpose not authorized by its charter, is not void, but voidable, and the sovereign alone can object. Neither the grantor nor his heirs nor third persons can impugn it upon the ground that the grantee has exceeded its powers. *Smith* v. *Sheeley*, 12 Wall. 358; *National Bank* v. *Matthews*, 98 U.S. 621; *National Bank* v. *Whitney*, 103 U.S. 99; *Reynolds* v. *Crawfordsville Bank*, 112 U.S. 405; *Fritts* v. *Palmer*, 132 U.S. 282; *Leazure* v. *Hillegas*, 7 Serg. & R. (Pa.) 313. Thus, although the statute by clear implication forbids a national bank from making a loan upon real estate, the security is not void and it cannot be successfully assailed by the debtor or by subsequent mortgagees because the bank was without authority to take it; and the disregard of the provisions of the act of Congress upon that subject only lays the bank open to proceedings by the Government for exercising powers not conferred by law. *National Bank* v. *Matthews*, *supra; National Bank* v. *Whitney*, *supra; Swope* v. *Leffingwell*, 105 U.S. 3.

In *National Bank* v. *Matthews, supra,* viewing that case in this aspect, the court said: —

"Where a corporation is incompetent by its charter to take a title to real estate, a conveyance to it is not void, but only voidable, and the sovereign alone can object. It is valid until assailed in a direct proceeding instituted for that purpose. *Leazure* v. *Hillegas*, 7 Serg. & R. (Pa.) 313; *Goundie* v. *Northampton Water Co.*, 7 Pa. St. 233; *Runyon* v. *Coster*, 14 Pet. 122; *The Banks* v. *Poitiaux*, 3 Rand. (Va.) 136; *McIndoe* v. *The City of St. Louis*, 10 Missouri, 575, 577. See also *Gold Mining Co.* v. *National Bank*, 96 U.S. 640."

This rule, while recognizing the authority of the Government to which the corporation is amenable, has the salutary effect of assuring the security of titles and of avoiding the injurious consequences which would otherwise result. In the present case a trust was declared and this trust should not be permitted to fail and the property to be diverted from those for whom it was intended, by treating the conveyance to the bank as a nullity, in the absence of a clear statement of legislative intent that it should be so regarded.

The cases in this court, which are relied upon by the plaintiff in error, are not applicable to the facts here presented and are in no way inconsistent with the doctrine to which we have referred. *McCormick* v. *Market Bank*, 165 U.S. 538; *California Bank* v. *Kennedy*, 167 U.S. 362; *Concord First National Bank* v. *Hawkins*, 174 U.S. 364.

It was also urged by the plaintiff in error that the deed was not accepted by the bank, and was inoperative for that reason. The Supreme Court of Missouri held upon the evidence that it was accepted, and this court, on a question of that character, does not review the findings of fact which have been made in the state court. *Waters-Pierce Oil Co.* v. *State of Texas*, 212 U.S. 86; *Egan* v. *Hart*, 165 U.S. 188; *Clipper Mining Co.* v. *Eli Mining & Land Co.*, 194 U.S. 220.

Assuming that the deed was accepted by the bank, it was effective to pass the legal title, and the plaintiff in error as heir at law of the grantor cannot question it.

Judgment affirmed.

NOTE. — I. No collateral attack will be permitted on the power of a corporation to be a conduit of title. *Morris* v. *Hall*, 41 Ala. 510, 537; *Sherwood* v. *Alvis*, 83 Ala. 115 (A mortgages to M, B purchases at the foreclosure sale, and may maintain ejectment against A); *Bigbee Co.* v. *Moore*, 121 Ala. 379 (M subscribed to and took stock in N, and transferred to A. A may recover dividends from N); *Barnes* v. *Suddard*, 117 Ill. 237; *Lathrop* v. *Commercial Bank*, 8 Dana (Ky.) 114; *Shewalter* v. *Pirner*, 55 Mo. 218; *Ragan* v. *McElroy*, 98 Mo. 349; *Parish* v. *Wheeler*, 22 N.Y. 494, 504; *Matter of Long Acre*

Co., 188 N.Y. 361, 369; *Mallett* v. *Simpson*, 94 N.C. 37, 41; *Leazure* v. *Hillegas*, 7 S. & R. (Pa.) 313; *Goundie* v. *Northampton Water Co.*, 7 Pa. St. 233; *Gilbert* v. *Hole*, 2 S.Dak. 164; *National Bank* v. *Stewart*, 107 U.S. 676; *Fritts* v. *Palmer*, 132 U.S. 282; *Lantry* v. *Wallace*, 182 U.S. 536.

The grantee, B, from M, contracts to sell to C. B may have specific performance. *Walsh* v. *Barton*, 24 Ohio St. 28.

II. The grantor to a corporation of property which it was *ultra vires* for the corporation to receive cannot recover the property, or have his conveyance removed as a cloud on title. *Morris* v. *Hall*, 41 Ala. 510, 537 (A may not maintain trover against M); *Long* v. *Georgia Ry. Co.*, 91 Ala. 519, 521; *Hough* v. *Cook County Land Co.*, 73 Ill. 23; *Hayden* v. *Hayden*, 241 Ill. 183; *Edwards* v. *Fairbanks*, 27 La. Ann. 449 (judgment creditors of A seize the chattels, and M is allowed to intervene in the execution proceedings and recover the chattels); *Ragan* v. *McElroy*, 98 Mo. 349; *Pittsburgh Co.* v. *Altoona Co.*, 196 Pa. 452. See also *Miner's Ditch Co.* v. *Zellerbach*, 37 Cal. 543, 606; *Barrow* v. *Nashville Co.*, 9 Humphrey (Tenn.) 304.

Similarly as to any privy of A. *Lathrop* v. *Commercial Bank*, 8 Dana 114; *De Witt Co. Bank* v. *Mickelberry*, 244 Ill. 77 (creditor of mortgagor not entitled to show that M had no power to purchase the land at foreclosure sale); *Baker* v. *Northwestern Co.*, 36 Minn. 185; *Christian Union* v. *Yount*, 101 U.S. 352, 361.

Conversely, the corporation cannot sue A to recover back the purchase price. *Hagerstown Mfg. Co.* v. *Keedy*, 91 Md. 430. To the same effect is *Baird* v. *Bank of Washington*, 11 S. & R. (Pa.) 411, 418.

A had land bounded by a lake. He deeded it to M, whose purchase was *ultra vires*. A has not thereafter the rights of a riparian proprietor against third parties. *Attorney-General* v. *Smith*, 109 Wis. 532.

III. The corporation may enforce the usual incidents of ownership against third persons.

M may enjoin A, or a privy of A, from interference with the property. *Alexander* v. *Tolleston Club of Chicago*, 110 Ill. 65; *Reynolds* v. *Crawfordsville Bank*, 112 U.S. 405, 413.

M may cause A to be indicted for a trespass upon Blackacre, which trespass is criminal because the ownership is in M, a municipal corporation. *Commonwealth* v. *Wilder*, 127 Mass. 1.

A sold a three-quarters interest in Blackacre to B, and a one-quarter interest to M. The land was sold to satisfy a lien in favor of A's grantor. The whole lien was satisfied out of B's share of the proceeds, on principles which would hold if M acquired title to the one-quarter. B was not allowed to show that M's taking was *ultra vires*. *Litchfield* v. *Preston*, 98 Va. 530.

A conveyed to B, the conveyance being voidable because of the fraud of B. B conveyed to M, who paid value and had no notice of the fraud. M has the rights of a *bona fide* purchaser against A. *Schneider* v. *Sellers*, 98 Tex. 380.

M may maintain ejectment against the casual possessor. *Natoma Co.* v. *Clarkin*, 14 Cal. 544, 552; *Chicago R.R. Co.* v. *Keegan*, 185 Ill. 70. *Contra*, *Catholic Congregation* v. *Germain*, 104 Ill. 440 (but see *Hamsher* v. *Hamsher*, 132 Ill. 273, 286); *Trustees* v. *Dickenson*, 1 Dev. L. (N.C.) 189 (M may not maintain detinue for shares against a stranger. Decided in 1827).

If the municipality damages Blackacre by changing the grade of the street, M may recover damages. *Louisville Property Co.* v. *Nashville*, 114 Tenn. 213 (foreign corporation).

M may lease Blackacre to B, and maintain an action for the rent against the lessee, *Rector* v. *Hartford Deposit Co.*, 190 Ill. 380, and the surety of the lessee, *Nantasket Co.* v. *Shea*, 182 Mass. 147. It may enforce other provisions of the lease. *Springer* v. *Chicago Trust Co.*, 202 Ill. 17; *Cowell* v. *Springs Co.*, 100 U.S. 55, 60.

M may maintain a petition under the Burnt Records Act to confirm its title. *Cooney* v. *Booth Packing Co.*, 169 Ill. 370.

M may acquire, by accretion, more land than it is authorized to hold and may maintain a bill to quiet its title to such land. *Chesapeake Co.* v. *Walker*, 100 Va. 69.

M conveys or sells to B, and may recover from B the purchase price according to the contract. *Slater Woollen Co.* v. *Lamb*, 143 Mass. 420; *Holmes & Griggs Co.* v. *Holmes & Wessell Co.*, 127 N.Y. 252, 260; *Rutland Co.* v. *Proctor*, 29 Vt. 93. And enforce a vendor's lien. *Fayette Land Co.* v. *Louisville R.R.*, 93 Va. 274.

If B contracts to buy, M may have specific performance. *Davis* v. *Old Colony R.R.*, 131 Mass. 258, 273; *Lancaster* v. *Amsterdam Improvement Co.*, 140 N.Y. 576, 584; *Banks* v. *Poitiaux*, 3 Rand. (Va.) 136.

A municipality could compel the sale to it of the property of a water company at a valuation, and sought so to do. It was obliged to pay for all the property held by the company for the purposes of its incorporation, whether that was in excess of the amount authorized or not. *West Springfield* v. *Aqueduct Co.*, 167 Mass. 128.

If M makes an *ultra vires* purchase of a negotiable instrument, it may enforce the note against prior parties. *Prescott National Bank* v. *Butler*, 157 Mass. 548 (and prior cases); *Merchants' Bank* v. *Hanson*, 33 Minn. 40 (directly overruling *Farmers' Bank* v. *Baldwin*, 23 Minn. 198, and *Bank of Rochester* v. *Pierson*, 24 Minn. 140); *Hennessy* v. *St. Paul*, 54 Minn. 219, 223; *Franklin Institution* v. *Roscoe*, 75 Mo. 408.

Contra, *Lazear* v. *National Union Bank*, 52 Md. 78, 125 (but see *United German Bank* v. *Katz*, 57 Md. 128, 141; *Black* v. *Bank of Westminster*, 96 Md. 399, 429).

If M makes an *ultra vires* purchase of a non-negotiable chose in action, it may enforce it in the same manner in which any other assignee could have enforced it. *State Ins. Co.* v. *Farmers Co.*, 65 Neb. 34, 41; *Farwell Co.* v. *Wolf*, 96 Wis. 10.

CALIFORNIA NATIONAL BANK *v.* KENNEDY.

167 U.S. 362. 1897.

THIS action was commenced in the Superior Court of the county of San Diego, State of California, against the California Savings Bank, and other defendants, including the plaintiff in error. In each of five counts of an amended petition a separate cause of action was stated, seeking a judgment against the savings bank for the amount of a particular deposit of money alleged to have been made with it on a specified date, and a recovery was asked against the other defendants upon the ground that they were stockholders in the savings bank on the dates of the various deposits, and in consequence liable under the laws of California to pay the debts of the savings bank in proportion to the amount of stock held and owned by each stockholder. A demurrer to the amended complaint was overruled, and the California National Bank answered, denying that it was ever the owner of any stock in the savings bank, and alleging that if any such stock was ever issued to it, it was issued without due authority from the bank in its corporate capacity and without authority of law. The answer also averred that the bank never acquired "in the usual course of business or now has as owner any stock of the said defendant, the California Savings Bank."

No issue was taken upon the truth of the averments in the amended complaint as to the amount and date of the respective deposits which plaintiff alleged he had made in the savings bank.

From the evidence it appeared that the savings bank began business in January, 1890. Its stock consisted of twenty-five hundred shares, and was originally distributed in five certificates, each for 500 shares, one certificate being made in the name of each of the following persons: J. W. Collins, S. G. Havermale, D. D. Dare, William Collier and H. F. Norcross. Norcross had no official connection with the national bank, but Collier, Dare and Collins were, respectively, president, vice president and cashier of the national bank, and were also, with Havermale, directors of the bank during the period when the alleged transfers of stock were made to the bank.

The certificates in the names of Collier and Norcross were never delivered, and when subsequently cancelled contained no indorsement. In the stead of those certificates, however, on September 10, 1890, three certificates, aggregating 990 shares, were issued in the

name of J. W. Collins, cashier, and two certificates, each for five shares, were issued to Collier and Norcross, respectively. On January 2, 1891, the three certificates for 990 shares in the name of Collins, cashier, were surrendered, and a single certificate for that number of shares was issued in the name of the California National Bank.

In December, 1890, and January, 1891, five per cent dividends were declared and paid on the stock of the savings bank. The amount of each dividend received by the California National Bank was $750. No direct evidence was introduced accounting for these payments having been made on the basis of an ownership of 1500 shares, when the bank was sought to be held liable for and appeared to be the holder of but 990 shares, put in its name as above stated. Both the savings bank and the national bank became insolvent; the former suspending November 12, 1891, while the receiver of the national bank qualified December 29, 1891.

The cause was tried by the court without a jury, and by findings of fact and conclusions of law rested thereon the court sustained the averments of the complaint, adjudged the national bank to be the holder of 990 shares of the stock of the savings bank, and responsible to the creditors of the savings bank in that proportion. Judgment was entered against the savings bank for $47,497.75, and against the national bank for $18,507.52, a payment to the savings bank, however, to be a satisfaction of the judgment against the national bank. Both at the hearing, by objection to the introduction in evidence of the certificate of stock, and in a statement filed with the motion for a new trial, the point was made that the issue of the stock to the bank was void because not shown to have been acquired pursuant to authority of its board of directors, and because the stock was not taken in the ordinary course of the business of the bank as security for the payment of a debt or otherwise. In addition, by the first, second and third specifications of errors of law occurring at the trial it was specially stated that error had been committed in admitting the certificate in evidence and holding the national bank liable — substantially the same language being employed in each specification — because the national bank, a corporation under the banking laws of the United States, could "not in law become a stockholder or incorporator in any other corporation." The motion for a new trial was overruled, and an appeal was taken to the Supreme Court of the State, by which court the judgment was affirmed. 101 California, 495. A writ of error was allowed, and the cause has been brought here for review.

Mr. Justice White. [After holding that a national bank has no power to purchase or subscribe to the stock of another corporation.[1]]

The transfer of the stock in question to the bank being unauthorized

[1] The opinion on this point is set forth at p. 415, *supra*.

by law, does the fact that, under some circumstances, the bank might have legally acquired stock in the corporation estop the bank from setting up the illegality of the transaction?

Whatever divergence of opinion may arise on this question from conflicting adjudications in some of the state courts, in this court it is settled in favor of the right of the corporation to plead its want of power, that is to say, to assert the nullity of an act which is an *ultra vires* act. The cases of *Thomas* v. *Railroad Company*, 101 U.S. 71; *Pennsylvania Railroad* v. *St. Louis, Alton &c. Railroad*, 118 U.S. 290; *Oregon Railway & Navigation Co.* v. *Oregonian Railway Co.*, 130 U.S. 1; *Pittsburgh, Cincinnati &c. Railway* v. *Keokuk & Hamilton Bridge Co.*, 131 U.S. 371; *Central Transp. Co.* v. *Pullman's Car Co.*, 139 U.S. 24; *St. Louis &c. Railroad* v. *Terre Haute & Indianapolis Railroad*, 145 U.S. 393; *Union Pacific Railway* v. *Chicago &c. Railway*, 163 U.S. 564, and *McCormick* v. *Market Nat. Bank*, 165 U.S. 538, recognize as sound doctrine that the powers of corporations are such only as are conferred upon them by statute, and that, to quote from the opinion of the court in *Central Transp. Co.* v. *Pullman's Palace Car Co.*, 139 U.S. 24, 59 to 60:

"A contract of a corporation, which is *ultra vires*, in the proper sense, that is to say, outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred upon it by the legislature, is not voidable only, but wholly void, and of no legal effect. The objection to the contract is, not merely that the corporation ought not to have made it, but that it could not make it. The contract cannot be ratified by either party, because it could not have been authorized by either. No performance on either side can give the unlawful contract any validity, or be the foundation of any right of action upon it."

This language was also cited and expressly approved in *Jacksonville &c. Railway* v. *Hooper*, 160 U.S. 514, 524, 530.

As said in *McCormick* v. *Market National Bank*, 165 U.S. 538, 549:

"The doctrine of *ultra vires*, by which a contract made by a corporation beyond the scope of its corporate powers is unlawful and void and will not support an action, rests, as this court has often recognized and affirmed, upon three distinct grounds: The obligation of any one contracting with a corporation to take notice of the legal limits of its powers; the interest of the stockholders not to be subject to risks which they have never undertaken; and, above all, the interest of the public that the corporation shall not transcend the powers conferred upon it by law. *Pearce* v. *Madison & Indianapolis Railroad*, 21 How. 441; *Pittsburgh, Chicago &c. Railway* v. *Keokuk & Hamilton Bridge Co.*, 131 U.S. 371, 384; *Central Transp. Co.* v. *Pullman's Palace Car Co.*, 139 U.S. 24, 48."

The doctrine thus enunciated is likewise that which obtains in England.

The circumstance that the dealing in stocks by which, if at all, the stock of the California Savings Bank was put in the name of the California National Bank, was one entirely outside of the powers conferred upon the bank, and was in nowise the transaction of banking business or incidental to the exercise of the powers conferred upon the bank, distinguishes this case from the class of cases relied upon by the defendant in error. *National Bank* v. *Whitney*, 103 U.S. 99; *National Bank* v. *Matthews*, 98 U.S. 621. The difference between those cases and one like this was referred to in *McCormick* v. *Market National Bank of Chicago, supra*, and it is, therefore, unnecessary to particularly review them. The claim that the bank in consequence of the receipt by it of dividends on the stock of the savings bank is estopped from questioning its ownership and consequent liability, is but a reiteration of the contention that the acquiring of stock by the bank under the circumstances disclosed was not void but merely voidable. It would be a contradiction in terms to assert that there was a total want of power by any act to assume the liability, and yet to say that by a particular act the liability resulted. The transaction being absolutely void, could not be confirmed or ratified. As was said by this court in *Union Pacific Railway* v. *Chicago &c. Railway*, 163 U.S. 564, speaking through Mr. Chief Justice FULLER (p. 581): —

"A contract made by a corporation beyond the scope of its powers, express or implied, on a proper construction of its charter, cannot be enforced, or rendered enforceable by the application of the doctrine of estoppel."

It follows from the foregoing that the judgment of the Supreme Court of California against the bank was erroneous, and it must, therefore, be

Reversed.

MR. JUSTICE HARLAN dissented.

NOTE. — The principal case was followed in *Concord First National Bank* v. *Hawkins*, 174 U.S. 364; *First National Bank* v. *Converse*, 200 U.S. 425; *Merchants' Bank* v. *Wehrmann*, 202 U.S. 295. And of course is binding on state courts in case of a national bank. *Chemical Bank* v. *Havermale*, 120 Cal. 601; *Leonhardt* v. *Small*, 117 Tenn. 153.

In *First National Bank* v. *Converse* (already referred to at p. 427, *supra*), a bank loaned money to a corporation, which became insolvent. There was a transfer of the assets of this corporation to a new corporation, by way of reorganization, and the bank, with other creditors, took preferred stock in the new corporation for its claim. About 17 years later, the second corporation became insolvent, and a receiver sought to enforce against the bank the liability incident to the ownership of such stock. The bank successfully defended on the ground that it was *ultra vires* for it to receive such stock.

That the result reached in the principal case was not based upon the lack of authorization by the directors is made plain by the facts and decisions in *Concord First National Bank* v. *Hawkins* and *First National Bank* v. *Converse*. In the first of these cases the court said (174 U.S. 364, 369): "The remaining question for our determination is whether the First National Bank of Concord, having, as a matter of fact, but without authority of law, purchased and held as an investment shares of stock in the Indianapolis National Bank, can protect itself from a suit by the receiver of the latter brought to enforce the stockholders' liability, by alleging the unlawfulness of its own action." And that the authorization by the entire body of stockholders would make no difference is plain from the reasoning of the court in *Central Transportation Co.* v. *Pullman's Car Co.*, 139 U.S. 24, *infra*, and the cases based thereon. "The contract cannot be ratified by either party, because it could not have been authorized by either. No performance on either side can give the unlawful contract any validity, or be the foundation of any right of action upon it." And that the same result would have been reached even if the corporation was solvent is plain from the cases just cited, — that is to say, the court is not proceeding on the narrow ground that *ultra vires* creditors must be deferred to *intra vires* creditors.

Such a decision is a logical deduction from the reasoning of Lord CAIRNS in *Ashbury Co.* v. *Riche*, *supra*, as to corporate legal capacity and was to be expected in England. But in the United States, the cases already given, or noted, in this section show that a corporation may be liable for an *ultra vires* act (*National Bank* v. *Graham*, 100 U.S. 699; *Salt Lake City* v. *Hollister*, 118 U.S. 256); and that a transfer to it of property, *ultra vires* for it to hold, usually becomes a foundation to it of the rights commonly incident to the ownership of such property (*National Bank* v. *Matthews*, *supra; Cowell* v. *Springs Co.*, 100 U.S. 55, 60; *Reynolds* v. *Crawfordsville Bank*, 112 U.S. 405, 413). It is submitted that such transfer should also usually be a foundation of the liabilities commonly incident to the ownership of such property.

See, in *accord* with the principal case, *Converse* v. *Emerson*, 242 Ill. 619.

See, *contra*, *Fidelity Insurance Co.* v. *German Savings Bank*, 127 Iowa, 591; *Hunt* v. *Hauser Malting Co.*, 90 Minn. 282; *Security Bank* v. *St. Croix Co.*, 117 Wis. 211, 218. See also *Turtelot* v. *Whithed*, 9 N.D. 467, 476; *Wright* v. *Pipe Line Co.*, 101 Pa. 204.

A religious corporation holding property *ultra vires* is not exempt from taxation on such property. *Evangelical Society* v. *Boston*, 204 Mass. 28.

Matter of McGRAW.

111 N.Y. 66. 1888.

APPEAL from a judgment of the Supreme Court, which reversed a decree made by the Surrogate of Tompkins County on the settlement of the account of Douglass Boardman, executor of the will of Mrs. Jennie McGraw Fiske. The will of Mrs. Fiske directed that her estate "be converted into money, or available securities, as soon as can be done, having in view its best interests and results." After numerous bequests including a bequest of $250,000 to Cornell University in trust, the will contains the following residuary clause: "I give, devise and bequeath all the rest, residue and remainder of my property (if any there shall be) to Cornell University, aforesaid, to be added to the 'McGraw Library Fund' aforesaid, and subject to the trusts, purposes, uses and conditions hereinbefore prescribed for said fund."

The Revised Statutes provide that a devise of real estate may be made to every person capable by law of holding real estate; "but no devise to a corporation shall be valid unless such corporation be expressly authorized by its charter or by statute to take by devise." (2 R.S. 57, §§ 1, 2, 3.) The Revised Statutes also enact, that the trustees of every college chartered by the State shall have power "to take and hold, by gift, grant, or devise, any real or personal property, the yearly income or revenue of which shall not exceed the value of twenty-five thousand dollars." (1 R.S. 460, §§ 31–37.) Cornell University was incorporated by chapter 585 of the Laws of 1865. Section 5 of the charter is as follows: "Sec. 5. The corporation hereby created may hold real and personal property not exceeding three millions of dollars in the aggregate."

The husband, next of kin, and heirs at law, of Mrs. Fiske, contended that Cornell University, at the date of Mrs. Fiske's death, already owned property exceeding, in the aggregate, three millions of dollars.

The amount of Mrs. Fiske's estate was such that, after deducting the legacies to parties other than Cornell University, there was a balance of more than one million which would go to the University if the will were carried out.

PECKHAM, J. The counsel states accurately the law of mortmain in England and its consequences of possible forfeiture of the estate granted, and, until forfeiture, the vesting of the title in the corporation indefeasible, except by the reëntry of the person entitled to take it by reason of the forfeiture. But the circumstances under which lands are held by citizens of New York, where their tenure is so wholly different from that which prevailed in England when the early mortmain acts were enacted, render any argument in regard to

those acts and their effect totally inapplicable to the case of a corporation of this State. Taking the law as it exists in our statutes, including the special provision upon the subject in the charter of the university, it seems to me that the provision therein, limiting the holding of property, is, as I have said, a restriction also upon the power to take in excess of the specified amount. The nature of the tenure of real property at the time of the passage of the early mortmain acts in England bears no resemblance to the tenure by which a citizen of this State holds lands. Here there is no vassal and superior, but the title is absolute in the owner, and subject only to the liability to escheat. (Const. of N.Y., art. 1, § 13.) The escheat takes place when the title to lands fails through defect of heirs. (Const. of N.Y., art. 1, § 11.)

A devise to a corporation which is forbidden to take (or forbidden to *hold*, *if the word*, under the circumstances of the case, is construed to include a taking also) does not, therefore, give a title subject to the right of some superior to claim a forfeiture of the land; but if it be in violation of a statute, I think the devise is void and the land descends to the heir or residuary devisee. . . .

Whether the legislature, when using language providing for a limitation upon holding property, meant to permit an unlimited taking, is a question of legislative intent; and I think the general inference would be, in the absence of some plain and controlling circumstance to the contrary, that the legislative body meant to limit a taking as well as a holding beyond the specified amount. . . .

The counsel for the appellant does not claim that this property was itself forfeited to the State, if the State should choose to enforce the forfeiture. His claim is, as I understand it, that if the university exceeded its limitation by holding more property than it was allowed by law to hold, a cause of forfeiture of the charter was thereby created, and that in enforcing such forfeiture, after the payment of the debts of the corporation the rest of the property would (as he insists) probably go to the State because there would be no living claimant to it who would have any right to acquire it. A forfeiture the State may claim and may enforce at pleasure, when the occasion arises, but it is a forfeiture of the charter and not a forfeiture of the property held by the corporation. It is further claimed that this distinction between the right to take and the power to hold property is one which has been admitted and enforced in the courts of England, of this State and of the other States of the Union for a long number of years; and that there is no reason why effect to such a distinction should not be given in this case, the result being, as is stated, that the corporation has an unlimited right to take property and also an unlimited right to hold it as against any one but the State in its capacity of sovereign. There is undoubtedly a distinction between the right to take and the power to hold property under some circum-

stances, the only question being whether the legislature had such distinction in mind and meant to provide for it in the case in hand. It is said that an alien has the right to take property by purchase, but he cannot hold it as against the State. That is so. He takes, however, a defeasible title, good as to all but the sovereign power, which must take it upon office found or by escheat. (*Wright* v. *Saddler*, 20 N.Y. 320.)

In such case it is not exactly an accurate description of the alien's title to simply say that he can take but cannot hold. That is a contradiction in terms. If he take, he must hold, if for but a fractional part of a second of time. The expression is but a short one for the statement that he cannot hold, as against the claim of the State, where properly made and enforced. The same expression is used in the case of a corporation under the mortmain laws, that it can take but not hold, the meaning being that it cannot hold as against the claim for forfeiture when made by the next superior lord of the grantor of the lands. That the words lose all their meaning when wrenched from the circumstances under which they were used, and applied to corporations existing by virtue of the laws of this State, seems to me a plain proposition.

But it is said that where property is given to a corporation which has power to take or hold under some circumstances, the title vests in the corporation, for otherwise the State would never obtain the right to forfeit even the charter for a violation thereof. The argument is, the corporation would answer a claim to forfeit the charter by the fact that the charter precluded it from taking such property, and, therefore, as it could not, it had not done so. I do not see the force of the argument. The charter may preclude the rightful taking of the property by the corporation, and may prevent the legal title from vesting in it, but that has nothing to do with the fact that, nevertheless, the corporation has, as a physical act, taken the property and may be insisting upon its right to keep it as matter of law. In such case can there be any doubt that the corporation has taken and is holding the property as its own and in defiance of the charter, and that it may be punished by having its charter forfeited, although the rightful owner of the property may thereafter obtain his own? The fact that he does obtain it is no answer to the other fact that the corporation had taken it, nor is it any legal answer to the claim of forfeiture of the charter, on the part of the State, that it was unsuccessful in continuing to hold the property against the charter provisions.

Although we never adopted or enacted the English statutes of mortmain, yet in this, as in other States, we have a decided mortmain policy. It is found in our statute in relation to wills, prohibiting a devise to a corporation unless specially permitted by its charter or by some statute to take property by devise.

"It is a statute of mortmain, resting on a mortmain policy as distinctly as any act of the British parliament. . . . The necessity is recognized of forbidding the acquisition by will, unless the legislature, in granting the charter, and in full view of the reasons for so doing, think proper to confer the power in express terms. . . . Nor is this necessity by any means a fanciful one. It is eminently praiseworthy to give in the interest of charity and religion. But in the last hours of life exaggerated impressions of charitable or religious duty often obscure the judgment of men and subject them to undue influence and persuasion. Against these the statute is intended to guard, because it is in behalf of associations incorporated for pious and benevolent purposes that the sentiments of men in such situations are most generally appealed to. *The enactment is, therefore, prohibitory and it ought to be expounded and applied in that sense.*" (Per COMSTOCK, Ch.J., in *Downing* v. *Marshall*, 23 N.Y. 366, 387.)

"Judges have given the widest possible scope to statutes in restraint of the disposal of property in mortmain, and have been astute in their arguments for the application of such statutes to cases as they arose. (Per GIBSON, Ch.J., *Hillyard* v. *Miller*, 10 Penn. 326.) The courts ought not to impute an intent to the legislature not clearly expressed, in direct hostility to the traditions and policy of the past. . . . Claiming property and seeking the aid of the courts to reach it, the corporation can rely only on the warrant and authority conferred by law, and cannot claim in transgression or excess of that authority. . . . Doubtless, the restriction upon corporations is a governmental regulation, and one of policy, and to be enforced by the government; but an individual whose interests will be affected by a transgression of the rule, may assert and insist upon the limitation as a restriction upon the power of the corporation to take." (Per ALLEN, J., in *Chamberlain* v. *Chamberlain*, 43 N.Y. 424–439.)

Under our general statutes upon the subject of the right to take or hold property by corporations, and reading them in connection with the provisions of the charter of the university, we should be astute in our arguments *against* the application of the mortmain statutes instead of in favor of them, if we should decide that the language of the charter did not apply as well to a taking as of a holding of property beyond the expressed limit.

There can be no doubt that it is the law, in this State at least, that if there be a prohibition against the taking of property beyond a certain amount or value, a devise or bequest to a corporation of property which will exceed the amount or value which the corporation is permitted to take, will be void for the excess. This is expressly decided in the *Chamberlain Case*, and we think it was rightly decided. Nor is there any doubt that in such a case the heirs or next of kin can raise the question. This was also decided in the same case. (See, also, *White* v. *Howard*, 46 N.Y. 144.) When we come to the

conclusion, therefore, that this university is by law precluded (or was precluded at the time of the death of Mrs. Fiske) from taking more than the amount of property limited in its charter, we bring the case precisely within the rules laid down in the cases just cited.

The counsel claims, however, that a devise to a corporation vests the title in it, so far as the question of capacity is concerned, whenever it would in the case of a sale for a valuable consideration. Hence he says that the cases of sales above cited are decisive of this, if they be admitted as well decided. In the case of an executed sale, however, the question of *ultra vires*, as set forth in the modern cases, comes in play, and the question of a want of title in the corporation in such case would not be permitted to be raised by the grantor or his heirs, because it would be against justice and would accomplish a legal wrong. (*Whitney Arms Co.* v. *Barlow*, 63 N.Y. 62.)

The question of an executed gift without consideration by a donor, by an absolute delivery to a corporation without power to take, is also instanced, and the question is asked whether the title vests in such a case in the corporation so that the donor or his heirs could not recover it back, and if it do, the counsel asks where is the difference in the two cases. It is time enough to decide such a case when it arises. But it seems to me there is a decided difference. In the one case the gift is made *inter vivos* by the absolute owner, and it is made effectual as to him by a delivery. In such case it would seem that *he* stands in no position to ask the aid of the court to get him out of a situation into which he voluntarily entered with his eyes open, and the court might well say to him that he stood in no position to attack the right of his donee to property which he freely and absolutely gave it. As to his heirs it could be said that their ancestor had made a disposition of property which was absolutely his own in his lifetime, and in such a way that he could not question its validity, and that as *he* could not, they succeeding only to his rights, were alike disabled.

In the case of a devise, however, the case is essentially different. The will does not take effect until the testator's death, and then, if his property is not legally devised or bequeathed, no title vests for a single moment in the devisee or legatee, but it vests instantly in the heir or next of kin; and the corporation claiming under the will asks the aid of the law to give the property to it, and in so doing it must show the authority it has to take. . . .

[After referring to the fact that the legislature, subsequently to the death of Mrs. Fiske, passed an act which took away any limitation on the power of the university to hold property.]

However perfect may be the waiver in the act alluded to, of the right of the State to forfeit the charter of this university on account of any alleged violation thereof, such act can, of course, have no possible effect upon rights of property which vested at the death of Mrs.

Fiske and before the passage of the act in question. (*White* v. *Howard*, 46 N.Y. 144.) . . .

This will devises no real estate to Cornell University. . . . [The will] directs that the estate of the testatrix shall be converted into money or available securities by her executor as soon as it can be done, having in view the best interests of the estate. This direction to convert operated as an equitable conversion of the estate of the testatrix into money or available securities, and hence no real estate in other states has been devised by her to the university. . . .

Upon a review of the whole question as to the proper construction of the legislation, general and special, affecting this university, I am of the opinion that it had no power to take or hold any more real and personal property than $3,000,000, in the aggregate.

Second. Coming to the conclusion I have, on the first branch of the case, it becomes necessary to examine the second and only remaining question, viz.: Does this property, if taken and held by the university, exceed the amount which by law it can hold?

[The court *held*, that the property of the university, at the time of the decease of Mrs. Fiske, amounted to more than "its permitted aggregate"; and that, under such circumstances, the university could not take the various legacies bequeathed to it by her will.]

Judgment of General Term affirmed.

All concur, except FINCH, J., taking no part.

NOTE. — Collateral attack upon the power of the corporation to receive property devised or bequeathed to it was also permitted in *Cromie* v. *Louisville Orphans' Home*, 3 Bush (Ky.) 365, 383; *Davidson College* v. *Chambers*, 3 Jones Eq. (N.C.) 253; *Wood* v. *Hammond*, 16 R.I. 98, 115; *House of Mercy* v. *Davidson*, 90 Tex. 529.

HUBBARD *v.* WORCESTER ART MUSEUM.

194 Mass. 280. 1907.

THE Worcester Art Museum was the residuary legatee in the will of Stephen Salisbury. If the intention of the testator were carried out, the Museum would receive, under the will, real and personal estate amounting in value to between $2,000,000 and $3,500,000. By the R.L. c. 125, § 8, such a corporation as the Museum was authorized to "hold real and personal estate to an amount not exceeding $1,500,000." By the St. 1906, c. 312, enacted after the probate of the will, the right of the Museum to hold real and personal estate was enlarged to an amount not exceeding $5,000,000. The petitioners, the heirs of Stephen Salisbury, contend that, by reason of the limitation in the statute, the gift was void; that, as heirs at

law of the testator, their rights in this part of his estate became vested on the probate of the will; that the St. 1906 is prospective in its operation, and does not affect the right of the respondent to hold property under this will, and that, if it were construed as applying to property devised by this will, it would be unconstitutional and void.

KNOWLTON, C.J. . . . We come directly to the effect of the residuary clause in the will.

The attack upon its validity may be considered from two points of view: first, in reference to the rights of testators, as against their heirs, to dispose of their property for charitable or other purposes; secondly, in reference to the provisions of the law giving this kind of corporations a right to hold property to an amount not exceeding a certain sum.

From the first point of view this gift is perfect and complete. Except for the protection of the statutory rights of a husband or wife, the power of a testator in this Commonwealth to dispose of his estate by a will is unlimited. There is nothing in our law to restrain one from giving free course to his charitable inclinations, up to the last moment of his possession of a sound, disposing mind. Making charitable gifts in this Commonwealth is not against public policy, and we have no legislation, such as has long existed in England and in New York and some of the other American States, putting obstacles in the way of such testamentary acts. The only ground of objection to this part of the will is not from the point of view of the testator or of his heirs, but on account of the provision of the statute regulating the rights of corporations as to the holding of property. We must, therefore, determine the meaning and effect of this statute on which the petitioners rely.

They contend that it is by implication an absolute prohibition against the holding, at any time, in any form, for any purpose, of a greater amount of property than that stated, and that any attempt of a corporation to hold more, or of any person to put more into the ownership of a corporation, is illegal and absolutely void. The respondent contends that this implied limitation of the right to hold is made on grounds of public policy; that it is a provision only in favor of the State, which the State may enforce or not, as it chooses; that grants or devises in excess of the amounts stated are not void, but only voidable; that third persons cannot question the validity of such grants or devises, but that they are legal so long as the State leaves them undisturbed, and that the State may at any time, by a legislative act or in some other proper way, completely waive its right of enforcement.

In interpreting the act the history of earlier kindred provisions may be helpful. At common law, corporations were authorized to acquire and hold both real and personal property without limit.

In re McGraw's Estate, 111 N.Y. 66, 84. "The creation of a corporation, gives to it, amongst other powers, as incident to its existence and without any express grant of such powers, that of buying and selling." *Bank* v. *Poitiaux*, 3 Rand. 136. "A corporation has, from its nature, a right to purchase lands, though the charter contains no license to that purpose." *Leazure* v. *Hillegas*, 7 S. & R. 313. See also *Page* v. *Heineberg*, 40 Vt. 81; *Mallett* v. *Simpson*, 94 N.C. 37, 41.

Under the feudal system, when land was given to a corporation, the chief lords of whom the land was held, and the king as ultimate chief lord, lost their chances of escheat, and various other rights and incidents of military tenure. During the middle ages, the accumulation of land in the ecclesiastical corporations was so great as to be thought a national grievance. Hence the English mortmain acts, which go back for their origin to Magna Charta. St. 9 Hen. III, c. 36, and which have continued with various modifications to this day. See 7 Edw. I, c. 2; 15 Rich. II, c. 5; Shelford on Mortmain, 2, 6, 8, 16, 25, 34, 39, 809, 812; Tyssen on Charitable Bequests, 2, 383. Under these acts the alienations were not void, so as to let in the grantors and their heirs; but they merely operated as a forfeiture which gave a right to the mesne lord and the king to enter after due inquest. This right to enter was often waived by a license in mortmain. See citations above, and Tyssen on Charitable Bequests, 383; St. 7 & 8 Will. III, c. 37. In form these licenses commonly authorized a holding of property "not exceeding" a certain value. In later years this authority sometimes has been inserted in the charter, and this limited power of purchase has, it is said, been exceeded by almost all corporations. Shelford on Mortmain, 55. See also pages 10, 44, 49, 56, 891; Tyssen on Charitable Bequests, 393, 394, 396.

Another act, St. 9 Geo. II, c. 36, which is usually called "The Mortmain Act" but is called by Tyssen the "Georgian Mortmain Act," is of a very different nature. One of its purposes, as declared in the preamble, is to avoid "improvident alienations or dispositions made by languishing or dying persons, or by other persons, to uses called charitable uses, to take place after their deaths, to the disherison of their lawful heirs." Considered in reference to its purposes, it is not properly called a mortmain act. It applies only to gifts for charitable uses; and under it all such gifts, unless made as the statute allows, are absolutely void.

We never have had any real mortmain acts in Massachusetts. The nearest approach to one was the Prov. St. 1754–55, c. 12; 3 Prov. Laws (State ed.) 778. This made deacons a corporation to take gifts for charitable purposes, limited the grants to such as would produce an income not exceeding three hundred pounds a year, and provided that they should be made by deed, three months before death, and that all bequests, devises or later grants should be void. This statute related only to gifts to deacons, and was repealed by

St. 1785, c. 51 (February 20, 1786), which re-enacted a part of the law, but omitted the provision that gifts not authorized by the act should be void. *Bartlet* v. *King*, 12 Mass. 537, 545. See R.L. c. 37, § 1.

The significance of this reference to English law and to our legislation is, first, that, except for this short period, we have never had in Massachusetts any legislation prohibiting charitable gifts to trustees or corporations, or providing that any kind of conveyances, devises or bequests to corporations shall be void. On the other hand, the policy of the Commonwealth, as expressed both by legislation and the decisions of its courts, has been exceedingly liberal to testators and public charities. *Sanderson* v. *White*, 18 Pick. 328, 333, 334; *American Academy* v. *Harvard College*, 12 Gray, 582, 595, 596; *Saltonstall* v. *Sanders*, 11 Allen, 446; *Jackson* v. *Phillips*, 14 Allen, 539, 550. Secondly, the implied limitations upon the power of corporations to hold property, which appear in numerous enactments, have been made, not in the interest of grantors or devisors or their heirs, but in the interest of the State, on considerations of public policy. The general form of these limitations, which appears in the statute before us, and with slight variations in special charters (a list of which, two hundred and seventy-four in number, granted in this State before 1850, has been furnished us through the industry of counsel), corresponds with the form of licenses granted by the Crown in England under the old mortmain acts, and sometimes embodied in charters granted by Parliament. Under these English acts, grants or devises to a corporation to hold property without a license, or in excess of the amount licensed, were not void, but only voidable by the mesne lord or the king, upon entry, after inquest according to law. In view of the close relations between Massachusetts and the mother country in early times, this justifies an argument, of considerable strength, that the implied limitations in our statutes were intended to have no greater force than the old mortmain acts of England, as distinguished from the Georgian mortmain act.

We start with the inherent right, already referred to, of every corporation to take and hold property at common law, by virtue of the act of its creation. This right is recognized in our statutes by implication, without express mention. R.L. c. 109, §§ 4–6. What force is to be given to the words, "may hold real and personal estate to an amount not exceeding one million five hundred thousand dollars"? The respondent contends that their meaning is as if words were added as follows: "and beyond that amount it shall have no right as against the Commonwealth; and the Commonwealth may take proper measures, through action of the Attorney General or otherwise, to prevent or terminate such larger holding." According to the argument, a taking and holding by a corporation, above the prescribed amount, is under its inherent right. As between it and

the State as the guardian of the public interest, a provision as to amount is made, which does not affect its right as to third persons. As to the general legality of the holding, except when the State chooses to enforce the law for its own benefit, the condition is similar to that resulting from a statutory provision which is merely directory. It is not very unlike the old law as to conveyances to aliens. Such conveyances, whether by grant or devise, were good against every one but the State, and could be set aside only after office found. *Fox* v. *Southack*, 12 Mass. 143; *Waugh* v. *Riley*, 8 Met. 290; *Judd* v. *Lawrence*, 1 Cush. 531; *Kershaw* v. *Kelsey*, 100 Mass. 561.

That this is the effect of such limitations in statutes of this kind where the title of the corporation is under a grant, as distinguished from a devise, seems to be the universal rule.

But if the statute were a prohibition that renders the holding utterly void, and the taking also void, as is argued in the opinion in *In re McGraw's Estate*, 111 N.Y. 66, anybody interested could take advantage of the violation of law, unless he was precluded by estoppel. Most of the cases which we have cited do not put their decision on the ground of estoppel. Often the question might arise when there was no estoppel. The ground on which most of the cases go is that the implication is not an absolute prohibition, but only a condition affecting the rights of the corporation as between it and the State. If the holding were an illegality which was utterly void, the condition would be the same whether the taking was by grant or devise, and a variety of unfortunate consequences might follow. The property might greatly increase in value after its acquisition, as was the case in *Evangelical Baptist Society* v. *Boston*, 192 Mass. 412. In that case, although the property of the corporation largely exceeded in value the amount authorized by the statute, there was no intimation that the holding was illegal, so long as the State did not interfere. See also *Humbert* v. *Trinity Church*, 24 Wend. 587, 605. As to all interests of private persons, in the absence of interference by the State, the cases generally treat titles to property held by corporations in excess of the specially authorized amounts as good. They allow the corporations to give good titles to purchasers of such property.

Some judges, in holding that such titles cannot be taken under wills, endeavor to found a distinction upon the executed character of a title by grant, and suggest that a devise or bequest is executory. It seems to us that there is no good reason for the distinction. When a will is proved and allowed, it takes effect immediately to pass all property affected by it. The provision in the law against large holdings by corporations has no relation to the probate of the will. The act of the testator in executing the will is confirmed and given effect as a complete and executed disposition of the property, by the allowance of the will. In this respect a recorded will does not

materially differ from a delivered deed. The heirs at law are bound by one as well as by the other.

The decisions upon the precise point at issue are conflicting. In *Jones* v. *Habersham*, 107 U.S. 174, a case similar to that now before us, it was held by the court, in an opinion by Mr. Justice GRAY, that, "restrictions imposed by the charter of a corporation upon the amount of property that it may hold cannot be taken advantage of collaterally by private persons." In the same case in the Circuit Court the question had been considered previously, and the same result was reached, in an opinion by Mr. Justice BRADLEY of the Supreme Court of the United States, which is found in 3 Woods, 443, 475. The same rule is established in Maryland. *Hanson* v. *Little Sisters of the Poor*, 79 Md. 434; *In re Stickney's will*, 85 Md. 79, 104. *DeCamp* v. *Dobbins*, 2 Stew. (N.J.) 36, 40, was decided by the Chancellor on this ground. The decree was affirmed on another ground in the Court of Errors and Appeals, 4 Stew. (N.J.) 671, 690, in an opinion by BEASLEY, C.J., which contains a dictum disapproving of the view of the Chancellor. In *Farrington* v. *Putnam*, 90 Maine, 405, the court, in a very elaborate opinion, in a case identical in its leading features with that now before us, held that the gift was good. The same doctrine is stated in *Brigham* v. *Peter Bent Brigham Hospital*, 126 Fed. Rep. 796, 801; s.c. 134 Fed. Rep. 513, 527. It is also stated in textbooks. Beach, Corp. (Purdy's ed.) § 825; Thompson, Corp. §§ 5795, 5797.

The leading case which presents the opposite view is *In re McGraw's Estate*, 111 N.Y. 66. Although the decision necessarily puts a construction upon a statute of that State, this construction seems to be materially affected by the policy of New York in reference to charities. Said Judge PECKHAM, who delivered the opinion, "We have a decided mortmain policy. It is found in our statute in relation to wills, prohibiting a devise to a corporation unless specially permitted by its charter or by some statute to take property by devise." In *Chamberlain* v. *Chamberlain*, 43 N.Y. 424, the court refers to the prohibition of devises, and to the N.Y. St. 1860, c. 360, still in force, which makes void all bequests or devises to charity in excess of one-half the testator's property, where he leaves relatives. Other statutes have been passed, limiting the amount that can be devised to certain corporations by one testator, forbidding a devise or bequest to charities, by a person leaving relatives, of more than one fourth of his estate, and making void such gifts where the will was executed within two months before the death of the testator. Gen. Laws of N.Y. 1901 (Heyd. ed.) 4885, 4891, 4892. The policy of that State in regard to charities has been very unfavorable. See *Allen* v. *Stevens*, 161 N.Y. 122, 139, 140; *People* v. *Powers*, 147 N.Y. 104; *Fosdick* v. *Hempstead*, 125 N.Y. 581.

In the construction of our statute, when the question arises

whether a different rule shall be established in regard to the taking and holding by a corporation under a will from that which is universally laid down in regard to a holding under a deed, we are much influenced by the policy of our law as to devises and bequests for charitable purposes. We are of opinion that, under the R.L. c. 125, § 8, a gift to a corporation under a will, to an amount in excess of the sum specially authorized, should be held no less valid than a similar acquisition of title under a deed. It is good as against every one but the Commonwealth. It follows that the St. 1906, c. 312, operated as a waiver of the Commonwealth's right to terminate the holding, and a legislative declaration of the entire validity of the provision in the will.

If we are wrong in this conclusion, the petition must be dismissed on an independent ground. The gift was to a public charity. The purposes of the Worcester Art Museum, as set forth in the agreement for its organization from which we have quoted, show the charitable uses to which all property held by it must be put. It is all held "solely in trust, for the benefit of all the people of the city of Worcester." We have no doubt that the property was given under the testator's will with a general charitable intent, with which the Worcester Art Museum, as a corporation, had no other connection than as an instrument to carry out the general purpose of the testator. In other words, the gift was not to the Worcester Art Museum as a corporation, apart from the charitable work in which it was engaged, nor on account of anything essential or peculiar in its performance of the charitable work described in its instrument of organization. The general charitable purpose was predominant in the mind of the testator, and not a desire to give to a particular corporation. The charitable purpose may be implied in the name or object of the devisee. *Winslow* v. *Cummings*, 3 Cush. 358; *Bliss* v. *American Bible Society*, 2 Allen, 334; *Incorporated Society* v. *Richards*, 1 Dr. & War. 258, 331. The object of the devisee, as a legally established public charity, was well known to the testator. To state the same proposition in other language, an implication to create a public charity may arise "from the character of the body to which the gift is made, or from publicly avowed purposes of its organization and action." *Old South Society* v. *Crocker*, 119 Mass. 1, 24; *Stratton* v. *Physio-Medical College*, 149 Mass. 505, 508. In such a case, if for any reason the donee named is incapable of executing the trust, the court will not allow the gift to fail for want of a donee. *Fellows* v. *Miner*, 119 Mass. 541; *Codman* v. *Brigham*, 187 Mass. 309; *Osgood* v. *Rogers*, 186 Mass. 238; *Bliss* v. *American Bible Society*, 2 Allen, 334; *Sherman* v. *Congregational Home Missionary Society*, 176 Mass. 349; *Winslow* v. *Cummings*, 3 Cush. 358; *Attorney General* v. *Stephens*, 3 Myl. & K. 347; *Hayter* v. *Trego*, 5 Russ. 113; *Loscombe* v. *Wintringham*, 13 Beav. 87; *Swasey* v. *American Bible Society*, 57 Maine, 523; *Almy* v. *Jones*, 17 R.I. 265.

If the corporation, at the time of the probate of the will, was incapable of taking the property and carrying out the general charitable intent of the testator, the court, applying the doctrine of *cy pres*, would appoint a trustee to act in its place. Inasmuch as the Legislature, by the St. 1906, c. 312, has removed the only ground of its disability, a direction to turn over the property to the corporation would accomplish perfectly the purpose of the testator. *Baker* v. *Clarke Institution for Deaf Mutes*, 110 Mass. 88.

NOTE. — Collateral attack upon the power of the corporation to receive property devised or bequeathed to it was also denied in *Jones* v. *Habersham*, 107 U.S. 174; *Brigham* v. *Brigham Hospital*, 134 Fed. 513, 527; *White* v. *Howard*, 38 Conn. 342; *Eliot's Appeal*, 74 Conn. 586; *Hamsher* v. *Hamsher*, 132 Ill. 273; *Hayward* v. *Davidson*, 41 Ind. 212; *Farrington* v. *Putnam*, 90 Me. 405; *Hanson* v. *Little Sisters of the Poor*, 79 Md. 434; *In re Stickney's Will*, 85 Md. 79; *Chambers* v. *St. Louis*, 29 Mo. 543.

Cf. Chase v. *Dickey*, 212 Mass. 555. Mary Baker G. Eddy conveyed certain real estate, the net annual value of which was largely in excess of $2,000, to Dickey, and others, in trust, among other things, to dispose of the same in accordance with her will. By her will she gave her residuary estate to the First Church of Christ, Scientist, in Boston in trust, primarily, to be used for the purpose of promoting and extending the religion of Christian Science as taught by her. The plaintiffs, in behalf of the First Church, sought to compel a conveyance of such real estate by the said trustees. The Attorney General became a party, and, in his answer, set up R.L. c. 37, § 9, which provides that "the income of the gifts, grants, bequests and devises made to or for the use of any one church shall not exceed two thousand dollars a year," etc. Therefore, the State having challenged the gift, the principal case became inapplicable. But the court held that, if the trust were for a charitable purpose, the trust would not be allowed to fail, even if the named trustee was not permitted to receive the trust property.

C. Contracts.

MONUMENT NATIONAL BANK *v.* GLOBE WORKS.

101 Mass. 57. 1869.

HOAR, J. The single question presented for our decision in this cause, all others which arise upon the report having been waived, is, whether the note of a manufacturing corporation, in the hands of a holder in good faith for value, who took it before maturity, and without any knowledge that the makers had not received the full consideration, cannot be enforced against them, because it was in fact made as an accommodation note.

The argument for the defendants takes the ground that to issue an accommodation note is not within the powers conferred upon the corporation; and that, as any persons taking it had notice that it was the note of the corporation, they had notice that it was of no validity unless issued for a purpose within the scope of the corporate powers, and were therefore bound to ascertain not only that it was executed by the officer of the corporation who had the general authority to sign the notes which they might lawfully make, but that the purpose for which it was issued was such as the charter authorized them to entertain and execute.

The court are all of opinion that this position is not tenable, and that the defence cannot be maintained.

It has long been settled in this Commonwealth that a manufacturing corporation has the power to make a negotiable promissory note. *Narragansett Bank* v. *Atlantic Silk Co.*, 3 Met. 282. And it was held in *Bird* v. *Daggett*, 97 Mass. 494, as a just corollary to that proposition, that such a note in the hands of a holder in good faith for value is binding upon the maker, although made as an accommodation note. The question was not discussed, nor the reasons for the decision fully stated, in *Bird* v. *Daggett;* but it was assumed that the doctrine announced was clear and undoubted law.

The doctrine of *ultra vires* has been carried much farther in England than the courts in this country have been disposed to extend it; but, with just limitations, the principle cannot be questioned, that the limitations to the authority, powers and liability of a corporation are to be found in the act creating it: And it no doubt follows, as claimed by the learned counsel for the defendants, that when powers are conferred and defined by statute, every one dealing with the corporation is presumed to know the extent of those powers.

But when the transaction is not the exercise of a power not conferred on a corporation, but the abuse of a general power in a par-

ticular instance, the abuse not being known to the other contracting party, the doctrine of *ultra vires* does not apply. As was said by SELDEN, J., in *Bissell* v. *Michigan Southern & Northern Indiana Railroad Co.*, 22 N.Y. 289, 290: "There are no doubt cases in which a corporation would be estopped from setting up this defence, although its contract might have been really unauthorized. It would not be available in a suit brought by a *bonâ fide* indorsee of a negotiable promissory note, provided the corporation was authorized to give notes for any purpose; and the reason is, that the corporation, by giving the note, has virtually represented that it was given for some legitimate purpose, and the indorsee could not be presumed to know the contrary. The note, however, if given by a corporation absolutely prohibited by its charter from giving notes at all, would be voidable not only in the hands of the original payee, but in those of any subsequent holder; because all persons dealing with a corporation are bound to take notice of the extent of its chartered powers. The same principle is applicable to contracts not negotiable. When the want of power is apparent upon comparing the act done with the terms of the charter, the party dealing with the corporation is presumed to have knowledge of the defect, and the defence of *ultra vires* is available against him. But such a defence would not be permitted to prevail against a party who cannot be presumed to have had any knowledge of the want of authority to make the contract. Hence, if the question of power depends not merely upon the law under which the corporation acts, but upon the existence of certain extrinsic facts, resting peculiarly within the knowledge of the corporate officers, then the corporation would be estopped from denying that which, by assuming to make the contract, it had virtually affirmed."

This doctrine seems to us sound and reasonable; and in conformity with it, it was held in *Farmers' & Mechanics' Bank* v. *Empire Stone Dressing Co.*, 5 Bosw. 275, that an accommodation acceptance by an officer of a manufacturing corporation, on behalf of the company, was not binding, unless the consideration had been advanced upon the faith of the acceptance; but that if the consideration was paid in good faith after the acceptance, and upon the credit of it, it could be enforced.

So it was said by Lord ST. LEONARDS that he felt a disposition "to restrain the doctrine of *ultra vires* to clear cases of excess of power, with the knowledge of the other party, express or implied from the nature of the corporation, and of the contract entered into." *Eastern Counties Railway Co.* v. *Hawkes*, 5 H.L. Cas. 331, 373.

The cases on which the defendants rely are cases against municipal corporations, in respect to which the rule is much more rigid, or for the most part those in which the other contracting party had notice upon the face of the transaction of the want of corporate power.

There can be no doubt that it is very often true that a corporation may be responsible for the unauthorized, and even for the unlawful acts of its agents, apparently clothed with its authority. No corporation is empowered by its charter to commit an assault and battery; yet it has frequently been held accountable, in this Commonwealth, for one committed by its servants. Bills of a bank issued without consideration, and even stolen, are good in the hands of an innocent holder for value. Many other illustrations might be given, but enough has been said to show the principle on which our decision rests.

Judgment for the plaintiffs.

NOTE. — The cases, *accord*, are numerous. See *Stouffer* v. *Smith-Davis Co.*, 154 Ala. 301; *Miners' Ditch Co.* v. *Zellerbach*, 37 Cal. 543; *Credit Co.* v. *Howe Machine Co.*, 54 Conn. 357; *Jacobs Co.* v. *Southern Co.*, 97 Ga. 573; *Lucas* v. *White Line Transfer Co.*, 70 Ia. 541, 546; *National Bank* v. *Young*, 41 N.J. Eq. 531.

NATIONAL HOME BUILDING ASS'N *v.* HOME SAVINGS BANK.

181 Ill. 35. 1899.

MR. CHIEF JUSTICE CARTWRIGHT delivered the opinion of the court.

In November, 1893, Flora D. Bishopp made a trade of lots in the city of Chicago with the National Home Building and Loan Association, appellant, in pursuance of which appellant conveyed to her lot 10 in Lee Bros.' addition to Englewood, lots 15 and 16 in block 60 in Chicago University subdivision, and lot 36 in block 2 in Herring's subdivision. In exchange for these lots said Flora D. Bishopp and Jonathan D. Bishopp, her husband, conveyed to the building and loan association lots 5 and 6 in block 2 in Johnson & Clement's subdivision, and in the deed of the same it was agreed that the building and loan association should assume and pay an encumbrance on said lot 5 in the form of a trust deed executed by said Flora D. Bishopp and husband to Charles T. Page, trustee, to secure a note for \$3000 and interest. The trade was negotiated and carried out on the part of the association through J. O. Duncan, agent, who was employed by the association to negotiate loans and examine abstracts for it in Chicago, and he acted under the direction of the secretary of the association. After the exchange the association paid a mortgage of \$600 on said lot 5 and the delinquent interest on the mortgage assumed in the conveyance. On May 14, 1895, the board of directors passed a resolution that the assumption clause in the deed was made without authority of the association, and directed the execu-

tion and tender of a quitclaim deed of the lot to Flora D. Bishopp. The deed was made and tendered unconditionally, and the association thereby offered the lot to her without a return of the consideration or any other condition. The note for $3000, secured by the trust deed, was transferred to the Home Savings Bank, one of the appellees, and it filed its bill in the superior court of Cook county to foreclose the same, asking for a decree against Flora D. Bishopp, a sale of the mortgaged premises, and a decree against the building and loan association for such deficiency as might exist. The building and loan association answered that the trade was consummated by direction of its president and secretary, but the clause assuming the mortgage was inserted without their knowledge or authority and without the knowledge and authority of its board of directors, that such an agreement was *ultra vires* the corporation, and that it had tendered a quitclaim deed of the lot to the said Flora D. Bishopp. The bill was answered by Flora D. Bishopp and her husband, who admitted its material allegations and filed their cross-bill, alleging the agreement for an exchange of the properties and the conveyances and asking for a deficiency decree against the association. The building and loan association answered the cross-bill, setting up the same defense as before, and the cause was referred to a master, who reported in favor of a foreclosure and sale and a decree against the building and loan association for any deficiency in the payment of the debt, interest, fees and costs. Exceptions to the report were overruled and a decree was entered in accordance with it, which has been affirmed by the Appellate Court.

No objection is made to the foreclosure of the trust deed or the sale of the premises, and the only question involved in this appeal is whether the contract inserted in the deed, by which the defendant, the National Home Building and Loan Association, agreed to assume and pay the debt, is binding upon it. This defendant, which denied the binding force of the agreement, is a corporation organized under the provisions of an act entitled "An act to enable associations of persons to become a body corporate to raise funds to be loaned only among the members of such association," in force July 1, 1879. (Laws of 1879, p. 83.) As a corporation it is a creature of the law, having no powers but those which the law has conferred upon it. A corporation has no natural rights or capacities, such as an individual or an ordinary partnership, and if a power is claimed for it, the words giving the power or from which it is necessarily implied must be found in the charter or it does not exist. The law on this subject is stated by the Supreme Court of the United States in *Central Transportation Co.* v. *Pullman Palace Car Co.*, 139 U.S. 24, as follows: "The charter of a corporation, read in the light of any general laws which are applicable, is the measure of its powers, and the enumeration of those powers implies the exclusion of all others

not fairly incidental." The purpose of this corporation is the raising of funds to be loaned to its members upon the security of its stock and unencumbered real estate. Manifestly the business of trading in real estate or acquiring the same, except as incidental to their legitimate business, is wholly foreign to the purpose for which the State has created such corporations and conferred upon them corporate powers. They have no power to take and hold real estate, and contracts made for the purchase of it are not enforceable. (Endlich on Building Associations, §§ 305–308.) But for the purpose of collecting debts it is essential that they should have some power with respect to the real estate mortgaged to them, and for that purpose § 13 of the act for their incorporation provides as follows: "Any loan or building association incorporated by or under this act is hereby authorized and empowered to purchase at any sheriff's or other judicial sale, or at any other sale, public or private, any real estate upon which such association may have or hold any mortgage, lien or other encumbrance, or in which said association may have an interest, and the real estate so purchased, to sell, convey, lease or mortgage at pleasure to any person or persons whatsoever." Such corporations are not authorized, either by their charters or as an incident to their existence, to acquire or hold any real estate, except such as has been mortgaged to them or which they may have an interest in. Not only is this the rule to be derived from the act of the legislature authorizing their incorporation, under the general principles of law, but it is, and always has been, against the policy of the State to permit corporations to accumulate landed estates, or to own real estate beyond what is necessary for their corporate business or such as is acquired in the collection of debts. *Carroll* v. *City of East St. Louis*, 67 Ill. 568; *United States Trust Co.* v. *Lee*, 73 id. 142; *People* v. *Pullman Palace Car Co.* 175 id. 125; *First M.E. Church of Chicago* v. *Dixon*, 178 id. 260. It is also a settled principle of American jurisprudence. 5 Thompson's Law of Corporations, § 5772. If a building and loan association were permitted to invest its money in the purchase of real estate or to traffic or trade in such property instead of keeping within the powers conferred upon it by loaning such money and collecting it, it would not only be exercising powers not granted, but it would be carrying on a business inconsistent with the purpose of its creation and against the fixed and uniform policy of the State. In *People ex rel.* v. *Chicago Gas Trust Co.*, 130 Ill. 268, it was said (p. 292): "The word 'unlawful,' as applied to corporations, is not used exclusively in the sense of *malum in se* or *malum prohibitum*. It is also used to designate powers which corporations are not authorized to exercise, or contracts which they are not authorized to make, or acts which they are not authorized to do, — or, in other words, such acts, powers and contracts as are *ultra vires*." In *Central Transportation Co.* v. *Pullman Palace Car Co.*, *supra*, the

result of the decisions as to the exercise of powers not granted is summed up, as follows: "All contracts made by a corporation beyond the scope of those powers are unlawful and void, and no action can be maintained upon them in the courts, — and this upon three distinct grounds: the obligation of every one contracting with a corporation to take notice of the legal limits of its powers; the interest of the stockholders not to be subjected to risks which they have never undertaken; and above all, the interest of the public that the corporation shall not transcend the powers conferred upon it by law."

It is also argued that the building and loan association is estopped to raise the question whether the contract was *ultra vires* because it has received the benefit of the contract by the conveyance of property to it. That depends, as we think, upon the sense in which the term *ultra vires* is used. It has been applied indiscriminately to different states of fact in such a way as to cause considerable confusion. When used as applicable to some conditions, it has been frequently said that a corporation is estopped to make such a defense where it has received the benefit of the contract. For example, the term has been applied to acts of directors or officers which are outside and beyond the scope of their authority, and therefore are invasions of the rights of stockholders, but which are within the powers of the corporation. In such a case the act may become binding by ratification, consent and acquiescence, or by the corporation receiving the benefit of the contract. Again, it has been applied to cases where an act was within the authority of the corporation for some purposes or under some circumstances, and where one dealing in good faith with the corporation had a right to assume the existence of the conditions which would authorize the act. Where an act is not *ultra vires* for want of power in the corporation but for want of power in the agent or officer, or because of the disregard of formalities which the law requires to be observed, or is an improper use of one of the enumerated powers, it may be valid as to third persons. In the more proper and legitimate use of the term it applies only to acts which are beyond the purpose of the corporation, which could not be sanctioned by the stockholders. There would, of course, be no power to confirm or ratify a contract of that kind, because the power to enter into it is absolutely wanting. If there is no power to make the contract there can be no power to ratify it, and it would seem clear that the opposite party could not take away the incapacity and give the contract vitality by doing something under it. It would be contradictory to say that a contract is void for an absolute want of power to make it and yet it may become legal and valid as a contract, by way of estoppel, through some other act of the party under such incapacity, or some act of the other party chargeable by law with notice of the want of power.

The powers delegated by the State to the corporation are matters of public law, of which no one can plead ignorance. A party dealing with a corporation having limited and delegated powers conferred by law is chargeable with notice of them and their limitations, and can not plead ignorance in avoidance of the defense.

In *Durkee* v. *People*, 155 Ill. 354, the same rules were laid down, and it was pointed out that the cases where a corporation is estopped from asserting that a contract is *ultra vires* when it has received a benefit under the contract is where the making of the contract is within the scope of the franchise, and the contract is sought to be avoided because there was a failure to comply with some regulation or the power was improperly exercised. The following was then quoted from the opinion in *Davis* v. *Old Colony Railroad Co.*, 131 Mass. 258: "There is a clear distinction, as was pointed out by Mr. Justice CAMPBELL in *Zabriskie* v. *Cleveland, Columbus and Cincinnati Railroad Co.*, by Mr. Justice HOAR in *Monument Bank* v. *Globe Works*, and by Lord Chancellor CAIRNS and Lord HATHERLEY in *Ashbury Railway Carriage and Iron Co.* v. *Riche*, between the exercise by a corporation of a power not conferred upon it, varying from the objects of its creation as declared in the law of its organization, of which all persons dealing with it are bound to take notice, and the abuse of a general power or the failure to comply with prescribed formalities or regulations in a peculiar instance, when such abuse or failure is not known to the other contracting parties."

In this case the transaction was beyond the corporate powers and *ultra vires* in the strict and legitimate sense, and against public policy. It could not be ratified or become valid by acquiescence, since there was no power to make it. Flora D. Bishopp, who dealt with the corporation, was chargeable with notice of its powers and their limitations and its inability to enter into the contract. She could not make the void contract valid by acting under it. No action can be maintained upon the unlawful contract, and in such cases, if the courts can afford any remedy, it cannot be done by affirming or enforcing the contract, but in some other manner.

The decree of the superior court against the National Home Building and Loan Association for any deficiency that may exist, and for execution to collect the same, and the judgment of the Appellate Court affirming said decree in that respect, are each reversed.

Judgment reversed.

MR. JUSTICE CARTER, dissenting:

I do not agree to the doctrine announced in the decision of this case, that a corporation may not be estopped from pleading its own lack of corporate power. As I understand the decisions, it has long been the settled doctrine of this court that where the contract has

been wholly executed and the corporation has received the benefit of it, it will be estopped from setting up in defense of payment its own lack of power, under its charter, to enter into the contract, where the contract is not one either *malum in se* or *malum prohibitum.* I do not understand that the application of the doctrine of estoppel is confined to those cases where the contract is within the powers of the corporation, but only beyond the mere authority of its officers or agents. The doctrine of estoppel does not rest upon the principle of agency that there may be a ratification of the unauthorized acts of agents. It has been held, not only by this court but by many others, that in many cases the question of *ultra vires* can only be raised in a direct proceeding by the State to oust the corporation of its assumed and usurped powers. *Bradley* v. *Ballard,* 55 Ill. 413; *Kadish* v. *Garden City Building Ass.,*151 id. 531; *McNulta* v. *Corn Belt Bank,* 164 id. 427; *Eckman* v. *Chicago, Burlington and Quincy Railroad Co.,* 169 id. 312; *Darst* v. *Gale,* 83 id. 136.

NOTE. — When a corporation, sued upon a contract made in its name, seeks to defend on the ground that the contract was *ultra vires,* three questions arise: —

(1) Did the corporation have legal capacity to make the contract? If not, that is an end of the matter. There is no possibility of such a corporate act.

(2) If the corporation has such legal capacity, that means that there are human beings to whose acts in making such contract corporate significance will be given. Who are those human beings, — the directors alone, or the directors, plus the stockholders? And is it a fact that the contract was made by their authority? If not, that is an end of the matter. There has not in fact been such a corporate act.

(3) If there was such a corporate act, is the plaintiff barred from relief because affected with notice, actual or constructive, that this was an improper corporate act?

If the corporation is held not to have legal capacity to make such a contract, it is submitted that it is needless, and makes only for confusion of thought, to speak of the plaintiff as having had constructive notice of the powers of the corporation. There is not a word about such notice in Lord CAIRNS' opinion in *Ashbury Co.* v. *Riche, supra.*

Whether every person who deals with corporate officers is charged with constructive notice of the powers of the corporation is a question that has not received careful consideration by the courts. The doctrine seems to have arisen with respect to railroad companies, formed by special act. See *East Anglian Ry. Co.* v. *Eastern Counties Co.,* 11 C.B. 775 (the act of incorporation "is a public act, accessible to all, and supposed to be known to all"). It has been frequently laid down by courts in this country, without discussion. But there has been some dissent from making any such sweeping doctrine. Thus

in the *Bissell* case, Comstock, J., said (22 N.Y. 258, 281): "A traveller from New York to the Mississippi can hardly be required to furnish himself with the charters of all the railroads on his route, or to study a treatise on the law of corporations."

There is a square conflict of authority as to whether a corporation is ever liable upon an *ultra vires* contract. Some of the cases holding the corporation not liable are given in the next paragraph. The reasoning in these cases often confuses, it is submitted, the three questions stated at the opening of this note.

See *Chewacla Lime Works* v. *Dismukes*, 87 Ala. 344; *Byrne* v. *Schuyler Co.*, 65 Conn. 336; *Franklin Co.* v. *Lewiston Bank*, 68 Me. 43; *Western Maryland R.R. Co.* v. *Blue Ridge Co.*, 102 Md. 307 (cf. *General Home* v. *Hammerbacker*, 64 Md. 595, 606; *United German Bank* v. *Katz*, 57 Md. 128); *Davis* v. *Old Colony R.R. Co.*, 131 Mass. 258; *Dresser* v. *Traders' Bank*, 165 Mass. 120; *Hotchkin* v. *Third Bank*, 219 Mass. 234; *Ulman* v. *Golden Cross*, 220 Mass. 422 (cf. *Chester Glass Co.* v. *Dewey*, 16 Mass. 94, 102; *Slater Woollen Co.* v. *Lamb*, 143 Mass. 420; *N.Y. Bank Note Co.* v. *Kidder Press Mfg. Co.*, 192 Mass. 391, 404); *Greenville Compress* v. *Planters' Press*, 70 Miss. 669, 676 (cf. *Prairie Lodge* v. *Smith*, 58 Miss. 301); *Downing* v. *Mount Washington Road Co.*, 40 N.H. 230; *Simpson* v. *Building Assn.*, 38 Ohio St. 349; *Metropolitan Stock Exchange* v. *National Bank*, 76 Vt. 303.

DENVER FIRE INSURANCE CO. *v.* McCLELLAND.

9 Colo. 11. 1885.

Action by McClelland (plaintiff below) against Insurance Company.

Plaintiff's complaint alleges that, on June 12, 1882, defendant company issued a policy insuring plaintiff's growing crops against loss or damage by hail; that this policy was issued in consideration of $3.00 cash paid by plaintiff, and also of a note for $58.03 executed and delivered by plaintiff to defendant; and that on June 19, 1882, plaintiff's crops were damaged by hail.

Defendants' answer set up, as second defense, that the defendant company's articles of incorporation were duly recorded in two public offices long before the issuing of said policy; and that "neither the said The Denver Fire Insurance Company, its directors, stockholders or officers, had or have any right, power or authority" to enter into such a contract, and that all such acts as were alleged in the complaint respecting such contract were "absolutely null and void, each and every act being beyond the scope and power vested by the said articles of incorporation in defendant, the directors, stockholders, and officers."

The objects of the company, as defined in its articles were to insure buildings of all kinds erected or in process of erection, goods, wares and merchandise, machinery, mills, factories, smelters, foundries, machine shops, breweries and personal property of every description, whether in store, transit or use, from loss or damage by fire, and generally to do and transact all business necessary to effectually secure indemnity from loss or casualty by fire or lightning, and all other business transacted by fire insurance companies.

The plaintiff demurred to the second defense. The demurrer was sustained. The jury assessed the damages at $1,265.50.

STONE, J. In the case before us the contract, as made by the parties, appears to have been fully executed on the part of the appellee, so far as his right of action when brought was affected by it. He had paid a small portion of money on the amount of the premium agreed to be paid and had given a promissory note for the balance. This was all he had agreed to do; all that had been exacted of him by the insurance company, and this he had performed. It matters not that the note had not been paid, for it was not due when his right of action accrued and when he brought his suit.

It is not contended that the payment of the note was a condition precedent to his right of action against the company, since, at the time of bringing the action, the note lacked two months of maturity, and there was nothing to be done or performed by him under the contract. The performance already made by the appellee had been accepted by the appellant company, and, so far as it was concerned, the execution of the note was the same as a cash payment in full of the amount; the company had the benefit thereof. It is argued on behalf of the appellant that the courts ought in all such cases to sustain the defense of *ultra vires*, here interposed, on the ground of public policy; that the public which confers the corporate powers upon such companies has an interest in the protection of innocent stockholders and creditors of such companies by confining the exercise of corporate powers strictly within their authorized limits, and this is given in the books as the chief reason for the rule of decision in the cases which sustain the defense of *ultra vires*.

That the public has such an interest is quite true, but whether to afford such protection the defense of *ultra vires* is always necessary in such cases is another thing. Stockholders are but one portion of the public; another portion, with equal rights of protection, is that with whom these multiform corporations deal in the daily exercise of their assumed powers. And it seems illogical to assume that the interests of the public would be best subserved by a public policy which will allow a corporation, any more than an individual, to violate the principles of common honesty and claim exemption from the obligation of its contracts by pleading its own wrong-doing. Such policy would rather seem to offer a premium for dishonest dealing.

Besides, both the state which grants these corporate powers, and the stockholders for whose benefit such powers are exercised, have their remedies, the former by interfering to revoke the charter, and the latter by an action to restrain the unauthorized undertakings. While courts are inclined to maintain with vigor the limitations of corporate actions, whenever it is a question of restraining the corporation in advance from passing beyond the boundaries of their charters, they are equally inclined, on the other hand, to enforce against them contracts, though *ultra vires*, of which they have received the benefit. If the other party proceeds to the performance of the contract, expending his money and labor in the production of values, which the corporation appropriates, such corporation will not be excused on the plea that the contract was beyond its powers. *Bradley* v. *Ballard*, 55 Ill. 413.

Corporations have the capacity to do wrong, and may overstep the limits placed by the law to their powers, and when they violate their charters in this respect their acts are illegal, but not necessarily void. *Bissell* v. *Mich. etc., R.R. Co.*, 22 N.Y. 258.

The plea of *ultra vires* is not to be understood as an absolute and peremptory defense in all cases of excess of power without regard to other circumstances and considerations. The plea is not to be entertained where its allowance will do great wrong to innocent third persons. *Bissell* v. *Mich., etc., R.R. Co.*, 22 N.Y. 258. Where a certain act is prohibited by statute, its performance is to be held void because such is the legislative will. So where the consideration of a contract is by law illegal, as where the cause of action arises *ex turpe*. But where the act is not wrong *per se*, where the contract is for a lawful purpose in itself, has been entered into with good faith, and fairly executed by the party who seeks to enforce it, we must assent to the doctrine of those authorities which hold that the excess of the corporate powers of the contracting party which has received the benefit of the contract is an unconscionable defense, which may not be set up to exempt from liability the party so pleading it. And such, we think, is the case before us.

The answer of the insurance company does not deny the averment in the complaint that the company "was doing business in Larimer county, in the state of Colorado, as a general fire and hail insurance company." It does not deny that it entered into the contract of insurance with the appellee in manner and form as alleged in said complaint, nor that the contract was executed as averred. The sole defense upon which the appellant company relies here is its want of authority to insure against hail. By offering to insure the property of appellee against damage by hail, and by entering into the contract of insurance therefor, it claimed to possess the power so to do. It took the appellee's money and assumed the risk and obligation of paying the damage, much or little, that might occur, or of having

nothing at all to pay, if the contingency of damage should not happen within the time covered by the policy.

A loss having occurred, the company seeks exemption from the obligation it entered into by denying that it had any authority to do what it asserted the right to do when it voluntarily assumed the undertaking.

We are aware that the courts have been very slow to concede that a defendant setting up as a defense the *ultra vires* of a contract, where said contract was clearly not authorized, should be held liable on the contract, since this would appear to sustain the enforcement of an unauthorized contract, and therefore the cases show that whenever the courts could avoid this seeming inconsistency by resting the recovery upon some other ground they have done so. This has often led to equal inconsistency in other directions. The true ground would seem to be that of equitable estoppel, whereby the defendant is not permitted to rely upon or show the invalidity of the contract. In such case, the contract is assumed by the court to be valid, the party seeking to avoid it not being permitted to attack its character in this respect.

The point was strongly insisted upon by counsel for appellant in argument, that one dealing with a corporation is bound to know the extent of its powers to contract, that the corporate name itself indicates the scope of its business, and the record of its charter or articles of incorporation furnishes notice of the extent and limitation of its corporate powers and authority to contract.

While as a general proposition this is true, yet it must be conceded that this constructive notice is of a very vague and shadowy character. Every one may have access to the statutes of the states affecting companies incorporated thereunder, and to their articles of incorporation, but to impute a knowledge of the probable construction the courts would put upon these statutes and articles of incorporation to determine questions raised upon a given contract proposed, is carrying the doctrine of notice to an extent which can only be denominated preposterous. It was in answer to the same point that Chief Justice COMSTOCK observed, in his opinion in a leading case upon this question, that "a traveler from New York to Mississippi can hardly be required to furnish himself with the charters of all the railroads on his route, or to study a treatise on the law of corporations." *Bissell* v. *M.S. & N.J. R.R. Co.*, 22 N.Y. 258. It was urged in argument on behalf of appellant that the state, which created these corporations for public good, has such an interest in their existence and perpetuity that public policy should be interposed to keep them within the legitimate exercise of their powers. This may be true to a certain extent, and the state may interpose to revoke their charters for an abuse thereof; but we take it that it is no more the public policy of the state to protect the business of

private corporations than that of its individual citizens; and to invoke public policy in a case like the one at bar, in order to prevent a corporation from doing wrong, by punishing the other party, would differ little from asking a court, on the ground of public policy, to prevent the obtaining money or goods through false pretenses by holding that the party defrauded should be punished by the loss of his money or goods.

While such wrong may be prevented by interference on the part of the state, or stockholders of the company, it cannot well be said that to cure the evil it is necessary in every case to exempt the company from the liability of its unauthorized engagements.

We do not say that the directors or acting officers of such company may act in excess of their legitimate powers against the interests and contrary to the will of the stockholders of such company, but while admitting the excess of proper authority, we think, on principle and the weight of modern decisions, that if the stockholders, whose business it is to see that their own managing officers act within the proper scope of their powers, either expressly, or by silence impliedly, assent to acts done on their behalf in excess of authority, they should be held estopped to deny that such acts were authorized.

The appellant company here offered to pay back the money and return or cancel the note given for the policy, and counsel urgently contended that this is all that legally can or rightfully ought to be exacted. This would not place the appellee *in statu quo*. Every insurance company would be ready and willing to do that much after the loss had occurred, on condition of exemption from payment of the loss. The damage to appellee is the loss of his crops against which the appellant undertook to secure him. After the loss it was too late for appellee to insure in another company having unquestioned authority to insure against such loss.

We therefore conclude that since the contract of insurance, though it may have been beyond the scope of the proper object and purposes of the company as expressed and conferred by their articles of incorporation, was neither by statute nor by their charter expressly forbidden, nor in its nature illegal or improper, and since the conduct of the company in soliciting the insurance and entering into the contract therefor under the circumstances disclosed by this case was such that to exempt it from its engagements thereunder would result in injuring and defrauding the appellee, who in good faith dealt with the company under the belief of its rightful authority in the premises, the defense of the appellant company interposed against its liability on the contract is inequitable, unconscionable, and should not be allowed.

BECK, C.J., and HELM, J., concurring. Private corporations are creatures of statute, and derive their powers solely therefrom. Upon weighty considerations of public policy, and of private equity as well,

the principle has been universally recognized that the charters or general laws through which these corporations derive their existence absolutely control their action; that a contract made or an act done by them which is not in any manner authorized by some express provision of the charter or law of incorporation, or which may not be clearly implied therefrom, is *ultra vires;* and that such usurpation of power may be relied upon as a complete defense to a suit growing out of the unauthorized act or contract.

But, for the purpose of avoiding the infliction of manifest injustice in given cases, many courts of the highest respectability have seen fit to recognize an exception to the foregoing doctrine. This exception, when admitted, is always based upon principles largely analogous to those supporting equitable estoppels. The decisions recognizing it hold that where a corporation receives and retains the full benefit of a contract, and a failure to perform on its side would result in palpable injustice to the other contracting party, it is estopped from escaping liability thereunder through a plea of *ultra vires.*

We are inclined to the opinion that cases sometimes arise wherein this exception, properly understood and limited, should be held applicable. If a private corporation has accepted and retained the full benefits of a contract which it had no power to make, the same having been performed by the other party thereto; and if the transaction is of such a nature that the party thus performing will suffer manifest injustice and hardship unless permitted to maintain his action directly upon the contract, no other adequate relief being at his command, we think the defense of *ultra vires* may be disallowed. This, however, does not do away with the objectionable character of the unauthorized contract. It admits the legal wrong committed by the usurpation of power, but denies the equitable right of the corporation to profit through such wrong at the expense of parties contracting with it; the corporation, having received and retained the benefit of the contract, is denied the privilege of invoking the illegality of its act, and thus avoiding consequences naturally flowing therefrom.

The circumstances attending and surrounding the transaction now before us, in our judgment, render this an appropriate case for the application of the foregoing equitable doctrine. For this reason we concur in the conclusion arrived at by Mr. Justice STONE, who writes the principal opinion.

Affirmed.

NOTE. — See, *accord, Western Development Co.* v. *Caplinger,* 86 Ark. 287; *Bay City Ass'n* v. *Broad,* 136 Cal. 525; *Muncie Gas Co.* v. *Muncie,* 160 Ind. 97, 104; *In re Mutual Ins. Co.,* 107 Ia. 143; *Electric Co.* v. *Blue Rapids Township,* 77 Kan. 580; *Canal Co.* v. *St. Charles Co.,* 44 La. Ann. 1069, 1075; *Geraghty* v. *Washtenaw Co.,* 145 Mich.

635; *Bell* v. *Mendenhall*, 78 Minn. 57; *Whitehead* v. *American Lamp Co.*, 70 N.J. Eq. 581; *Parish* v. *Wheeler*, 22 N.Y. 494; *Trustees* v. *Realty Co.*, 134 N.C. 41, 49; *Clarke* v. *Olson*, 9 N.D. 364; *Boyd* v. *American Carbon Block Co.*, 182 Pa. 206; *Bond* v. *Terrell Co.*, 82 Tex. 309; *Bear River Co.* v. *Hanley*, 15 Utah, 506; *Farwell Co.* v. *Wolf*, 69 Wis. 10. For further authorities see 24 H.L.R. 544.

STATE *v.* BANK OF HEMINGFORD.

58 Neb. 818. 1899.

HARRISON, C.J. The Bank of Hemingford, a corporation formed under the laws of this State, and located and in business at Hemingford, purchased a store building and lots upon which it stood, also the stock of merchandise contained in the store, of all of which the bank afterward made a conditional sale to Mary E. Jones. The vendee defaulted in fulfillment of the conditions of the sale, and the bank took possession of the property on or about March 7, 1893, from which time until October 2, 1895, when the bank was closed and taken in charge by the state banking board, the bank had conducted the mercantile business. In the due course of proceedings to "wind up" the affairs of the bank a receiver was appointed, who took possession of the assets of the bank, inclusive of the store building, the real property upon which it was situated, also the stock of merchandise. The appellant had sold merchandise to the bank during the time the latter was running the store, and which had been placed therein as a part of the stock for sale, and sold in the course of the retail trade; and for the unpaid portions of the bill or accounts due and unpaid claims were duly presented to the receiver, each of which was returned indorsed: "Not filed, for the reason it is not a legal claim against the Bank of Hemingford. Dated December 20, 1895. Ira E. Tash, Receiver Bank of Hemingford." The appellants, by petition of intervention in the proceeding in district court wherein the receiver had been appointed, set up and asserted their respective claims, and after trial a decree was rendered by which certain claims for parties of amounts collected by the bank on accounts against a party who had owned and conducted the store (it was the conditional vendee of the bank and the debt contracted by her) were preferred, the depositors of the bank ordered paid in full, and if any assets remained they were to be applied in payment of the claims of appellants and others who had similar claims and who had also asserted them in the same manner as appellants had their claims. Appellants claim that they should have been accorded preferred claims against any amount in the hands of the receiver derived or realized from the sale of the store property, inclusive of the merchandise, or at least

should not have been postponed in favor of the other creditors of the bank. It is conceded by all parties, and is true, that the bank was not authorized to engage permanently or as a venture in the business of selling merchandise at retail, or to use the common general expression, "in keeping a store," and in so doing it proceeded without warrant in its articles of incorporation and hence without legal right. It has been decided that if a bank not authorized by its articles of incorporation engages in a business other than banking, an account for articles furnished it in and about the conduct of such business may be collected from it, and that it had no power to make the contract out of which the debt arises is of no avail to it as a defense in an action against it to recover the amount of the account. *American Nat. Bank* v. *National Wall Paper Co.*, 77 Fed. Rep. 85. But a receiver appointed, as in this case, under the provisions of our banking act will answer in such matters as herein in controversy, not alone for the bank or as representing or "standing in the shoes of the bank," but will guard, protect, and preserve the rights and interests of creditors, and look to and secure their proper adjustment relatively to all claims and each to the other. *Barrington* v. *Connor*, 51 Neb. 214.

In the absence of evidence to the contrary, and there is none, it will be presumed that the depositors dealt with the bank as a bank and not as a store-keeper, and believed it to be and trusted it as engaged in legitimate banking and not in ventures or transactions not contemplated in the articles of its incorporation, and in which its capital and funds, or a portion thereof, must be used, and they are entitled to demand of right that the funds diverted and employed for purposes other than the banking business, if such funds have been returned to or are in the possession of the bank, or, in the event of its insolvency, have been taken by its duly appointed receiver, together with any funds or property which in the course of the outside dealing have been mingled with what were originally put to the unauthorized use by the bank, be appropriated to the payment of their just claims against the bank to the exclusion of parties who have accounts against the bank which originated exclusively in the unauthorized business. The parties who trusted the bank as a storekeeper knew that it was an incorporated bank, and must have known, or will be charged with the knowledge, that it was not properly in the retail mercantile business.

It is urged with considerable stress that quite a large percentage of the goods, the accounts or bills for which were presented to the receiver as claims by the appellants, was in the stock in the store at the time it passed into the possession of the receiver of the bank; also, that there was an account in the books of the bank in which the store figured as a party and by or from which it was possible to ascertain what money had come to the bank from the store business as a source, and in this connection that the creditors of the bank, as a

store-keeper, ought to be preferred as to funds or property which came from the store to the bank or its receiver, or at least to share equally in them with the other creditors of the bank. There was evidence to the effect that "ninety per cent" of one bill of goods, the account for which was the basis of the claim of one of the appellants, remained unsold and in the stock in the store when the receiver took possession, and relative to some others of the claims of appellants similar conditions prevailed, except the per cents of goods named were smaller; but here it must be said that this is not an action to recover the specific articles or goods or their proceeds, but is in the nature of an action to recover on an account against the bank, and the evidence to which attention has been directed can have but little, if any, weight, except as it might avail to awaken and move the equitable feelings and powers of the court; but the appellants are in no position to invoke the equity powers of the courts as against the rights of the depositors and general creditors of the bank. There was also testimony to the effect that in the books of the bank an account had been kept with the store, and the record states that some pages of the books of the bank were introduced in evidence to show portions at least of the account with the store, but these are not in the record presented here, and from all that is before us on the subject it cannot be said that there is evidence which in any degree tends to show that funds taken from the bank to the store business had been fully repaid and that there were funds or profits from the store business to which the appellants might possibly, equitably, be said to have any right to demand they be paid on their claims as distinctively and specifically, to coin an expression, store funds. The decree of the district court was right and must be

Affirmed.

NOTE. — See also *Van Brocklin* v. *Queen City Printing Co.*, 19 Wash. 552, cited in the note on p. 449, *supra*.

CENTRAL TRANSPORTATION CO. *v.* PULLMAN'S CAR CO.

139 U.S. 24. 1890.

A CORPORATION, formed by articles of association, called a certificate or charter, under the general laws of Pennsylvania concerning manufacturing companies, with a certain capital stock, for twenty years, for "the transportation of passengers in railroad cars constructed and owned by the said company" under certain patents, carried on the business of manufacturing sleeping cars under its patents, and of hiring or letting the cars to railroad companies by written contracts, receiving a revenue from the sale of berths and

accommodations to passengers. Seven years afterwards, by a special act of the legislature of Pennsylvania, the charter was extended for ninety-nine years, and the corporation was empowered to double its capital stock, and "to enter into contracts with corporations of this or any other State for the leasing or hiring and transfer to them, or any of them, of its railway cars and other personal property." The corporation forthwith entered into an indenture with a corporation of another State engaged in a similar business, by which it leased and transferred to that corporation all its cars, railroad contracts, patent rights and other personal property, moneys, credits and rights of action, for the term of ninety-nine years, except so far as the contracts and patents should expire sooner; and covenanted not to "engage in the business of manufacturing, using, or hiring sleeping cars" while the indenture should remain in force; and the lessee covenanted to pay all existing debts of the lessor, and to pay to the lessor annually the sum of $264,000, during the entire term of ninety-nine years, unless the indenture should be sooner terminated as therein provided. The question was whether an action could be maintained by the lessor upon this contract to recover the sums thereby payable for a period during which the lessee had enjoyed the benefits of the contract.

MR. JUSTICE GRAY. . . . The clear result of these decisions may be summed up thus: The charter of a corporation, read in the light of any general laws which are applicable, is the measure of its powers, and the enumeration of those powers implies the exclusion of all others not fairly incidental. All contracts made by a corporation beyond the scope of those powers are unlawful and void, and no action can be maintained upon them in the courts, and this upon three distinct grounds: the obligation of every one contracting with a corporation, to take notice of the legal limits of its powers; the interest of the stockholders, not to be subjected to risks which they have never undertaken; and, above all, the interest of the public, that the corporation shall not transcend the powers conferred upon it by law. A corporation cannot, without the assent of the legislature, transfer its franchise to another corporation, and abnegate the performance of the duties to the public, imposed upon it by its charter as the consideration for the grant of its franchise. Neither the grant of a franchise to transport passengers, nor a general authority to sell and dispose of property, empowers the grantee, while it continues to exist as a corporation, to sell or to lease its entire property and franchise to another corporation. These principles apply equally to companies incorporated by special charter from the legislature, and to those formed by articles of association under general laws.

The view which this court has taken of the question presented by this branch of the case, and the only view which appears to us consistent with legal principles, is as follows: —

A contract of a corporation, which is *ultra vires*, in the proper sense, that is to say, outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred upon it by the legislature, is not voidable only, but wholly void, and of no legal effect. The objection to the contract is, not merely that the corporation ought not to have made it, but that it could not make it. The contract cannot be ratified by either party, because it could not have been authorized by either. No performance on either side can give the unlawful contract any validity, or be the foundation of any right of action upon it.

When a corporation is acting within the general scope of the powers conferred upon it by the legislature, the corporation, as well as persons contracting with it, may be estopped to deny that it has complied with the legal formalities which are prerequisites to its existence or to its action, because such requisites might in fact have been complied with. But when the contract is beyond the powers conferred upon it by existing laws, neither the corporation, nor the other party to the contract, can be estopped, by assenting to it, or by acting upon it, to show that it was prohibited by those laws.

The doctrine of the common law, by which a tenant of real estate is estopped to deny his landlord's title, has never been considered by this court as applicable to leases by railroad corporations of their roads and franchises. It certainly has no bearing upon the question whether this defendant may set up that the lease sued on, which is not of real estate, but of personal property, and which includes, as inseparable from the other property transferred, the inalienable franchise of the plaintiff, is unlawful and void, for want of legal capacity in the plaintiff to make it.

A contract *ultra vires* being unlawful and void, not because it is in itself immoral, but because the corporation, by the law of its creation, is incapable of making it, the courts, while refusing to maintain any action upon the unlawful contract, have always striven to do justice between the parties, so far as could be done consistently with adherence to law, by permitting property or money, parted with on the faith of the unlawful contract, to be recovered back, or compensation to be made for it.

In such case, however, the action is not maintained upon the unlawful contract, nor according to its terms; but on an implied contract of the defendant to return, or, failing to do that, to make compensation for, property or money which it has no right to retain. To maintain such an action is not to affirm, but to disaffirm, the unlawful contract.

The ground and the limits of the rule concerning the remedy, in the case of a contract *ultra vires*, which has been partly performed, and under which property has passed, can hardly be summed up better than they were by Mr. Justice MILLER in a passage already

quoted, where he said that the rule "stands upon the broad ground that the contract itself is void, and that nothing which has been done under it, nor the action of the court, can infuse any vitality into it"; and that "where the parties have so far acted under such a contract that they cannot be restored to their original condition, the court inquires if relief can be given independently of the contract, or whether it will refuse to interfere as the matter stands." *Pennsylvania Railroad* v. *St. Louis, &c., Railroad,* 118 U.S. 317.

Whether this plaintiff could maintain any action against this defendant, in the nature of a *quantum meruit,* or otherwise, independently of the contract, need not be considered, because it is not presented by this record, and has not been argued. This action, according to the declaration and the evidence, was brought and prosecuted for the single purpose of recovering sums which the defendant had agreed to pay by the unlawful contract, and which, for the reasons and upon the authorities above stated, the defendant is not liable for.

Judgment affirmed.

NOTE. — See, *accord, Bank of Chillicothe* v. *Swayne,* 8 Ohio, 257; *Marble Co.* v. *Harvey,* 92 Tenn. 116.

BATH GAS LIGHT CO. *v.* CLAFFY.

151 N.Y. 24. 1896.

THE plaintiff is a Maine corporation, created under a special law of that State, passed in 1853, for the purpose of supplying gas for the lighting of the streets and buildings in the city of Bath. The United Gas, Fuel and Light Company is a Maine corporation, organized in 1888, under a general law of that State.

On November 10, 1888, the plaintiff company executed to the United, etc., Company a lease of its property and franchises for the term of twenty-five years from November 1, 1888, at an annual rent of $2500, which the lessee covenanted to pay in semi-annual payments on the first day of May and the first day of November in each year, and also the taxes assessed during the term. Provision was made for the payment by the lessor to the lessee, at the expiration of the term, of the value of any improvements or extensions made by the lessee, and it was also provided that the lessee should give to the lessor a satisfactory bond for the faithful performance by the lessee of its covenants in the lease. In pursuance of the provision last mentioned, the United Gas, Fuel and Light Company, on the same day, executed a bond with the defendants John Claffy and John T. Rowland as sureties, conditioned for the faithful performance by the

company of the covenants in its behalf contained in the lease, which bond was delivered to and accepted by the plaintiff. The sureties were interested in the United Gas, Fuel and Light Company as stockholders, and Claffy (the appellant) was also a director. The lessee immediately, upon the execution of the lease, entered into possession of the demised property and paid the rent up to the 1st day of November, 1889, but defaulted in the semi-annual payment due May 1st, 1890, and on the 2d day of August, 1890 (the rent remaining unpaid), the plaintiff reëntered and took possession of the demised property under a provision of the lease which authorized the lessor to enter and expel the lessee on failing to pay rent. The entry also was, as may be inferred, with the consent and, indeed, at the suggestion of the officers of the lessee. This action was brought on the bond against the lessee and the sureties to recover as damages the rent which fell due May 1, 1890, and the proportionate rent from that date up to August 2, 1890, and taxes which had been assessed against the property during its occupation by the lessee, which it had failed to pay.

The defendant Claffy alone appeared and defended the action.

The court below gave judgment in favor of the plaintiff. Claffy appealed.

ANDREWS, CH.J. The defendant Claffy alone appeared and defended the action. His sole defense to the general claim is that the lease was *ultra vires*, illegal and void, because (as is conceded) it was made without legislative sanction. If the court is compelled to accede to this contention by force of controlling authority, or from considerations of public policy which overbear in the particular case the rules of ordinary justice, it will be our duty so to declare and to say that, although the United Gas, Fuel and Light Company received and enjoyed the undisturbed possession of the demised property under the lease until the reëntry, and accepted and appropriated the benefit of the contract, nevertheless, when called upon to pay the rent which accrued during its occupation, it may defend itself on the ground that the plaintiff, in making the lease, exceeded its power and escaped the performance of its obligation, and, further, that the defendant Claffy may, for a like reason, avoid his guaranty.

The modern doctrine, as stated by Chancellor KENT, is to consider corporations as having such powers as are specifically granted by the act of incorporation, or as are necessary for the purpose of carrying into effect the powers expressly granted, and as not having any others. 2 Kent Comm. 299. This doctrine is embodied in the Revised Statutes of New York, and the section relating to the subject is regarded as simply declaratory of the antecedent law. 1 Rev. St. 600, § 3. It has been frequently stated that the validity of contracts of corporations is to be determined by comparing the contract made with the charter, and if upon such comparison it appears that

the contract was neither expressly authorized, nor a necessary or reasonable incident to the exercise of the powers specifically granted, the contract is *ultra vires*. It seems that by the ancient common law a corporation could bind itself by a contract under its corporate seal, although the contract was not within the powers specified in the charter, and even although it contained negative words. This was in substance stated by BLACKBURN, J., in the case of *Riche* v. *Ashbury Railway Carriage Co.*, L.R. (9 Exch.) 262, citing as authority *Sutton's Hospital Case*, 10 Co. 1. He said: "If there are conditions contained in the charter that the corporation shall not do particular things, and those things are nevertheless done, it gives ground for a proceeding by *sci. fa.* in the name of the crown to repeal the letters patent creating the corporation. But if the crown take no such steps it does not, as I conceive, lie in the mouth either of the corporation or of the person who has contracted with it to say that the contract into which they have entered was void as beyond the capacity of the corporation." The case came before the House of Lords on appeal from the decision of the Exchequer Chamber in favor of the plaintiff, and its judgment is reported in L.R. (7 Eng. & Ir. App.) 653. The action was to enforce a contract entered into by the defendant, a corporation incorporated under the Companies Act of 1862. The judgment of the Exchequer Chamber was reversed on the ground that the contract sued upon was expressly prohibited by the act under which the defendant was incorporated, and was, therefore, void. The House of Lords applied the general doctrine that an act done in contravention of an express statute is utterly void.

The modern and reasonable doctrine that contracts into which corporations may lawfully enter are such only as are expressly or impliedly authorized by their charters, is nevertheless frequently disregarded in practice, and when this is done and a corporation enters into a contract beyond its chartered powers, the question arises which has been the subject of debate and of much difference of opinion, how shall such a contract be treated by the courts, and whether the contract can create any rights as between the parties which the courts will enforce. There are some propositions pertaining to the general subject which are beyond dispute. One is, that a contract by a corporation to do an immoral thing, or for any immoral purpose, or, to use a convenient expression, a contract *malum in se*, is void and gives no right of action. The doctrine, however, is not peculiar to contracts of corporations. It has its root in the universal principle that persons shall not stipulate for iniquity. Another principle of general recognition is that a corporation cannot enter into or bind itself by a contract which is expressly prohibited by its charter or by statute, and in the application of this principle it is immaterial that the contract, except for the prohibition, would be lawful. No one is permitted to justify an act which the legislature within its

constitutional power has declared shall not be performed. The series of cases in this state, known as the Utica insurance cases, afford an apt illustration. It was held that the restraining acts which prohibited the exercise of banking powers, including the discount of paper, by other than banking corporations, rendered void securities taken on such discount by corporations not possessing banking powers, and this, although the object of the restraining laws seems to have been the protection of the chartered banks in the monopoly of banking.

But in not infrequent instances corporations enter into unauthorized contracts, which are neither *mala in se* nor *mala prohibita*, or when the only prohibition or restriction is implied from the grant of specified powers. It is this class of cases which open the field of controversy. Is such a contract performed by one party, but not performed by the other, void as between them to all intents and purposes, so that no recovery can be had under it against the party who has received the consideration for his promise, but neglects or refuses to perform it, or is it so tainted with illegality that the courts must refuse to recognize it under any circumstances or enforce its obligation, whether as to past or future transactions? There are certain English cases which are relied upon by those who maintain the strict view that contracts of corporations *ultra vires* are under no circumstances enforceable in the courts. The principal of these cases are *The East Anglian Railways Co.* v. *The Eastern Counties Railway Co.*, 11 C.B. 775; *Macgregor* v. *The Dover & Deal Railway Co.*, 18 Ad. & El. 618, and *The Ashbury Railway Carriage Co., Limited*, v. *Riche*, L.R. 7 Eng. & Ir. App. 653. The *East Anglian* case seems to have been the first one in England which sustained a defense of *ultra vires* interposed by a corporation as a defense to an action at law on a contract made in the name of the corporation. See opinion of ERLE, J., *Mayor of Norwich* v. *Norfolk Railway Co.*, 4 El. & Bl. 397. The defendant in that case, a railway corporation owning and operating a railway, entered into a contract with another railway company, by which it agreed to pay the parliamentary expenses which might be incurred by the latter company in the effort to obtain authority to extend its lines, whether the grant should be obtained or not, the intention being to turn over the concessions if obtained, together with the original line, to the defendant under a lease, for which a parliamentary sanction was to be applied for. The concessions were only in part obtained, and no authority to make the proposed lease was given, and the project was finally abandoned. The action was brought on the contract to recover the expenses incurred by the plaintiff, amounting to more than twenty thousand pounds. It was held that the plaintiff was not entitled to recover, on the ground that the statute under which the defendant was incorporated prescribed that the funds of the defendant should be applied to the purposes for which it was incorporated, and that it could not legally enter into a

contract involving the application of any portion of its funds to other purposes. The opinion relies upon cases in equity brought by shareholders to restrain the misapplication of corporate funds. The case of *Macgregor* v. *The Dover & Deal Railway*, and the case of *The Ashbury Railway Carriage Company*, though differing in detail, were decided upon the same principle, but in the latter case there was an express statutory prohibition which was regarded as prohibiting the contract there in question. It is important to observe that in each of these cases the action was brought against the offending corporation, or those in privity with it, to enforce the unauthorized contract while it was still executory on the part of the corporation, and that the effect of a recovery would have been to divert and appropriate the funds of the corporation by the action of the courts, to unauthorized objects, to the prejudice of the legal rights of stockholders and creditors. Without questioning these cases, it is quite apparent that they stand in justice upon a very different basis from the action in this case, which is brought by the corporation to enforce a contract, the enforcement of which will indemnify the plaintiff and its stockholders for the deprivation of the use of the property of the corporation, during its possession by the defendants, under the unauthorized lease. The Supreme Court of the United States seems to be committed to a construction of the doctrine of *ultra vires* which would sustain the defense in the case now before us. Several cases have arisen in that court upon leases of railroads made without legislative sanction, in which it has been held that such leases are void as between the parties, and that no action can be maintained thereon to recover the rent reserved, even during the occupation by the lessee under the lease. In *Thomas* v. *Railroad Company*, 101 U.S. 71, the defendant had leased to the plaintiffs a railroad for a term of years, reserving an option to terminate the lease at any time during the term, and the defendant, in case such option should be exercised, covenanted to submit to arbitration the ascertainment of the loss and damage to the plaintiffs by reason of such termination of the lease, and to abide by the award. The defendant exercised the option and terminated the lease and resumed possession of the road, and an action was brought for a breach of the contract in respect to arbitration. The trial court determined the case against the plaintiffs on the ground that the contract sued upon was in substance a lease of the property and franchises of the defendant, which having been executed without legislative authority was illegal and void, and the Supreme Court affirmed the judgment. The action, it will be observed, was in substance an action to recover the value of the unexpired term of which the plaintiffs had been deprived by the action of the defendant, and the covenant sued upon was wholly executory. But, in the subsequent cases of *Pa. Railroad Co. et al.* v. *St. Louis, A. & T.H. R.R. Co.*, 118 U.S. 290; *Oregon Railway & Nav. Co.* v.

Oregonian Railway Co., 130 U.S. 1, and *St. Louis, V. & T.H. Railroad Co.* v. *Terre Haute & Indianapolis Railroad Co.*, 145 U.S. 393, which were actions by lessor against lessee to recover rent accrued under leases of railroads during the occupation by the lessees, it was broadly held that as the leases were made without legislative sanction they were void, and that no action could be maintained thereon to recover the past due rent, although the lessees were and still remained in undisturbed possession of the demised property. Mr. Justice MILLER, in the case in 118 U.S., expressed a doubt whether there could be a recovery on a *quantum meruit.* We concur with the opinion expressed by two of the learned justices of the court, who dissented from the judgment in the case last cited, that the decision carried the doctrine of *ultra vires* to an unjust extent, and the rank injustice which, as it seems to us, these cases sanction, justifies the observation of Lord ST. LEONARDS in the case of *The Eastern Counties Railway Co.* v. *Hawkes*, 5 H.L. Cas. 347, 370, that "the safety of men in their daily contracts requires that the doctrine of *ultra vires* should be confined within narrow limits."

We concede that a railroad or other corporation invested with powers in the exercise of which the public have an interest, and empowered by reason of its *quasi* public character to do acts and exercise privileges peculiar and exceptional to enable it to discharge its public duties, cannot, as against the public, abdicate its functions or absolve itself from the performance of such duties through an unauthorized transfer of its property and franchises to another body or corporation. We have so held in the case of *Abbott* v. *The Johnstown, etc., Railroad Co.*, 80 N.Y. 27, where it was decided that a railroad corporation which, without legal sanction, had leased its road, was not thereby exempted from liability as carrier to a passenger injured by negligence during the operation of the road under the lease.

There are obvious reasons of propriety and public policy, the prevention of monopolies, among others, aside from the mere question of capacity under their charters, which enforce the now well-settled doctrine, that leases by such *quasi* public corporations, to be valid and effectual, must be authorized by statute. But where, as in the present case, such an unauthorized lease has been made, and the lessee has received and enjoyed the possession of the property under the lease, is there any public policy which requires that the lessee should be permitted to escape the obligation imposed by the contract to pay the rent reserved during the enjoyment of the property? It is doubtless true, as has been suggested, that the corporation in such cases cannot, without the consent of the State, change its obligations to the State or the public, and discharge itself from its public duties. But the law affords ample remedy for the usurpation by corporations of unauthorized powers, through proceedings by in-

junction or for the forfeiture of their charters. If a lease by a corporation, made in excess of its powers and without legislative sanction, is illegal in the ordinary and proper sense of the term, it may be properly conceded that no action could be maintained upon it. The lessee, when sued for the rent, could set up the illegality of the contract, and the defense would prevail, however inequitable the defense might be. But the term "illegal," which is frequently used to describe a contract made by a corporation in excess of its corporate powers, in most cases means simply that the contract is unauthorized, or one which the corporation had no legal capacity to make. Such a contract may be illegal in the true and proper sense, but it may also be one involving no moral turpitude and offending against no express statute. The inexact and misleading use of the word "illegal," as applied to contracts of corporations, *ultra vires* only, has been frequently alluded to. Comstock, C.J., *Bissell* v. *M.S. Railroad Co.*, 22 N.Y. 268; Archibald, J., *Riche* v. *Ashbury Railway Carriage Co.*, L.R. (9 Exch.) 293; Lord Cairns, *S. C.* on appeal, L.R. (7 Eng. & Ir. App.) 672.

The lease now in question was not in any true sense of the word illegal. It was undoubtedly void as against the State. The parties to the lease assumed it to be valid. It was contemplated, as the provisions of the lease show, that the lessee would continue and extend the business before carried on by the plaintiff, and it is not suggested that it did not, during its occupation, discharge all the obligations to the public which rested upon the plaintiff. The State has not intervened, and the possession of the property has now been restored to its original proprietors. The contract has been terminated as to the future, and all that remains undone is the payment by the lessee of the unpaid rent. We think the demands of public policy are fully satisfied by holding that, as to the public, the lease was void, but that, as between the parties, so long as the occupation under the lease continued, the lessee was bound to pay the rent, and that its recovery may be enforced by action on the covenant. Public policy is promoted by the discouragement of fraud and the maintenance of the obligation of contracts, and to permit a lessee of a corporation to escape the payment of rent by pleading the incapacity of the corporation to make the lease, although he has had the undisturbed enjoyment of the property, would be, we think, most inequitable and unjust. It has been suggested, to avoid the apparent injustice which would result from holding that there could be no recovery on the contract for past-due rent, that there might be a remedy on an implied contract to pay the value of the use of the property. But if the express contract was illegal in a proper sense, and the parties to the lease were guilty of a public wrong, so as to preclude a court of equity to entertain jurisdiction on the application of a lessor to be relieved from the lease and to be restored to the possession of the

leased property, as was held in the case of *The St. Louis, V. & T.H. Railroad Co.* v. *Terre Haute & I. Railroad Co.*, 145 U.S. 393, then surely it would be a mere evasion and would be inconsistent with legal principles for the court to imply a contract from the occupation under the illegal lease to relieve the wrongdoer from the dilemma into which he had voluntarily placed himself. We think the rule which should be applied is that the lessee is bound by the contract so long as he remains in possession.

It is unnecessary now to determine whether a lessee under an *ultra vires* lease may relieve himself from liability in the future by abandoning the possession and restoring, or offering to restore, it to the lessor.

VANN, J., dissented.

NOTE. — *Mutual Life Ins. Co.* v. *Stephens*, 214 N.Y. 488. A lease was made which provided that upon a certain contingency an appraisal should be made of the leased premises and that the lessee should have an option to purchase at the appraised value. Improvements of the leased property were made by the lessee, or the assigns of the lessee. Plaintiff, a life insurance company, claimed to be the assignee of the lease, and brought an action to compel specific performance of the provision relating to appraisal. The lessors defended on the ground that it was *ultra vires* for the plaintiff to acquire the premises in question. MILLER, J., said (p. 493): "We shall assume for the purposes of this appeal that the statute (Insurance Law, § 20) does not authorize the plaintiff to acquire and hold the said real property. It now has an estate for years in the property and the question arises whether a court of equity will aid it to acquire the fee. If the agreement were wholly executory the answer to that question would not be doubtful. *Chamberlain* v. *Chamberlain*, 43 N.Y. 424; *Matter of McGraw*, 111 N.Y. 66; *Case* v. *Kelly*, 133 U.S. 21. But it has been so far executed that it is impossible to restore the parties to their original situation. Improvements have been made on the faith of the agreement and presumably the plaintiff will lose the value of its investment in whole or in part unless the agreement is carried out. The defendants have recognized the plaintiff as their tenant and have accepted performance of the contract from it. They should not now be permitted to plead its *ultra vires* act to avoid performing their part of the agreement, certainly not without first paying or offering to pay the value of the improvements. *Appleton* v. *Citizens' Central National Bank*, 190 N.Y. 417. The record does not disclose under what circumstances or for what purpose the plaintiff acquired the lease. We assume that it exceeded its corporate powers. But the act was not *malum in se*, nor does the statute expressly prohibit the acquisition of real property by insurance corporations for any purpose. On the contrary, it authorizes such corporations to

purchase, hold and convey real property, but only for certain enumerated purposes. The acquisition of the lease by the plaintiff, assuming that it was not acquired for one of the enumerated purposes, was unlawful only in the sense that it was *ultra vires.* As the Insurance Law stood when the plaintiff acquired the lease, it could hold such real property indefinitely 'as shall have been acquired for the accommodation of its business.' (Laws of 1892, chap. 690, § 20.) But as the act was amended by chapter 326 of the Laws of 1906 it is required to sell and dispose of such property within five years after acquiring title unless it shall be necessary for its accommodation in the convenient transaction of its business, or unless it shall procure a certificate from the superintendent of insurance extending the time during which it may hold the same. If the property is not necessary for the plaintiff's accommodation in the convenient transaction of its business, it will be for the superintendent of insurance to see that the statute is complied with precisely as would be the case if, instead of acquiring a lease, it had taken a mortgage which it had to foreclose. The option to purchase must be exercised now, if at all. Neither public policy nor good morals require that the plaintiff shall be burdened with a lease without having the privilege to exercise the right thereby given to acquire the fee, and it is of no concern to the defendants who exercises that right. It is not for them to enrich themselves because the plaintiff may have exceeded its corporate powers, but it is solely for the State to challenge the plaintiff's *ultra vires* act."

But *cf. Africani Loan Ass'n* v. *Carroll,* 267 Ill. 380.

D. Quasi Contracts.

CITIZENS' NATIONAL BANK *v.* APPLETON.

216 U.S. 196. 1909.

MR. JUSTICE HARLAN delivered the opinion of the court.

This action was commenced in the Supreme Court of New York by the Receiver of the Cooper Exchange Bank, a New York corporation, against the Citizens' Central National Bank of New York, a national bank corporation formed by the consolidation (Rev. Stat., §§ 5220 and 5221) of the Central National Bank of the city of New York with the National Citizens' Bank of the same city. The action was dismissed on demurrer to the complaint, and that judgment was affirmed in the Appellate Division. 116 App. Div. 404. But on appeal to the highest court of New York the judgment was reversed, 190 N.Y. 417, and the cause was remitted to the Supreme Court of that State for judgment in accordance with the opinion of the former court.

The complaint alleges —

That the defendant, the Citizens' National Bank of New York, by the consolidation referred to, acquired all the assets and became subject to the liabilities of the Central National Bank of that city;

That on and prior to January 4th, 1904, one Michael Samuels was indebted to the Central National Bank in the sum of $10,000;

That "at the instance and request of Samuels, trading under the name of Mikael Samuels & Co., *and the Central National Bank of the city of New York*," the Cooper Exchange Bank loaned and advanced to the former the sum of $12,000, Samuels executing his written obligation, dated January 4th, 1904, to return or repay the same on or before four months after date with interest, and *at the same time* the Central National Bank of the city of New York, under seal, executed a written guaranty for the payment of the debt, as follows: "For and in consideration of one dollar and other good and valuable considerations, the Central National Bank of the city of New York hereby guarantees to the Cooper Exchange Bank the payment at maturity of a loan of twelve thousand dollars, made this day to Mikael Samuels & Co. by the Cooper Exchange Bank;"

That previous to the obtaining of said loan of $12,000, Samuels "agreed with the said Central National Bank to pay to it the said sum of $10,000 *of the said* $12,000 *so obtained*, and the said loan was obtained by the said Mikael Samuels and was guaranteed by the said Central National Bank *in order that the said Central National Bank might obtain the said sum of* $10,000, which it did receive and which was owed to it by the said Samuels;"

That previous to the maturity of the loan, namely, on January 30th, 1904, only a few weeks after the loan was made, Samuels was adjudged a bankrupt; and,

That no part of said loan had ever been paid, except $1,000, which was paid April 7th, 1906.

The Court of Appeals of New York — CULLEN, C.J., delivering the opinion — held and the counsel for the Cooper Exchange Bank conceded in that court, that no recovery could be had against the guaranteeing bank in excess of the amount actually received by it out of the $12,000 loaned, as above stated. 190 N.Y. 417. The case being remitted to the inferior state court, judgment was therefore rendered against the defendant only for $10,000, with interest from January 4th, 1904, with costs in all courts.

The plaintiff in error insists that the guaranty given by the Central National Bank to the Cooper Exchange Bank was beyond its power, was in violation of the National Banking Act, and, therefore, could not be made the foundation of an action against the guarantor bank. But this action need not be regarded as one on the written contract of guaranty, but as based on an implied contract between the Cooper Exchange Bank and the Central National Bank, whereby the latter, under the circumstances disclosed by the record, came under a duty to account to the former for the $10,000 *of the* $12,000 actually paid to Samuels *at its request and on its guaranty.* The law would be very impotent to do justice if it could not, under those circumstances and without violating established legal principles, compel the Central National Bank to recognize and discharge that duty. Samuels owed the Central National Bank $10,000, and — with knowledge perhaps of his financial condition — he was put forward by that bank to obtain $12,000 from the Cooper Exchange Bank so that it could get $10,000 *out of that sum,* for its own use. The circumstances show that the latter bank would not have loaned the money to Samuels except at the request and on the guaranty of the Central National Bank. All this, it may be observed, occurred under a previous agreement between the Central National Bank and Samuels, that that bank was to have $10,000 of the $12,000 in discharge of its claim upon him. In short, the Central National Bank, by means of the device mentioned, got $10,000 of the money of the Cooper Exchange Bank for its own use, and having used it for its own benefit, it now seeks to avoid liability therefor, upon the ground that it was not allowed by the law of its creation to execute the guaranty in question. We know of no adjudged case that stands in the way of relief being granted as asked by the plaintiff. But there are many that will authorize such relief. . . .

These views are supported by many other adjudged cases. In *Central Transportation Co.* v. *Pullman's Car Co.*, 139 U.S. 24, 60, the court, speaking by Mr. Justice GRAY, said: "A contract *ultra*

vires being unlawful and void, not because it is in itself immoral, but because the corporation, by the law of its creation, is incapable of making it, the courts, while refusing to maintain any action upon the unlawful contract, have always striven to do justice between the parties, so far as could be done consistently with adherence to law, by permitting property or money, parted with on the faith of the unlawful contract, to be recovered back, or compensation to be made for it. In such case, however, the action is not maintained upon the unlawful contract, nor according to its terms, but on an implied contract of the defendant to return, or, failing to do that, to make compensation for, property or money which it has no right to retain. To maintain such an action is not to affirm, but to disaffirm the unlawful contract." So, in *Pullman's Car Co.* v. *Transportation Co.*, 171 U.S. 138, 151, the court, speaking by Mr. Justice PECKHAM, said: "The right to a recovery of the property transferred under an illegal contract is founded upon the implied promise to return or to make compensation for it."

We need not go farther. It is entirely clear that the judgment against the defendant bank — which came into the possession of the property, and was subject to the liabilities of the Central National Bank — was consistent with sound legal principles and was intrinsically right, even if the guaranty in question was beyond the power of the guaranteeing bank, under the national banking statutes. Whatever may be said as to the validity of the written guaranty, now alleged to be illegal, the judgment can be supported as based wholly on the implied contract, which made it the duty of the Central National Bank, under the facts disclosed, to account to the Cooper Exchange Bank for the money obtained from the latter in execution of the agreement made by the former with the borrower.

The judgment must be affirmed.

It is so ordered.

E. Liability of Human Beings.

SANFORD *v.* McARTHUR.

18 B. Mon. (Ky.) 411. 1857.

This suit was brought by Sanford, who held a large amount in notes purporting to be notes of the Newport safety fund bank of Kentucky, all of less denomination than five dollars, against McArthur, who was, during its existence, the president of the bank. A judgment was asked against McArthur individually for the amount of said notes.

As appears by the charter of the bank, as originally passed by the legislature, all notes to be issued thereby were to be printed and engraved by the auditor of the state, and to be secured by the deposit of stocks or mortgages and real estate. Said notes were to be numbered and registered by the auditor, and countersigned by him before they were delivered to the president of the bank. By an amendment to the charter notes of a less denomination than five dollars were authorized to be issued without being countersigned by the auditor; this alone was dispensed with, all other provisions of the original charter remained unchanged by the amendment. Sanford, in his petition, charges that under color of this amendment of the charter the president, McArthur, confederated with others, some of whom were directors, and caused to be issued large amounts of notes of various denominations under five dollars, which were not received from the auditor, nor printed, nor engraved, nor numbered, nor registered, by him, and for the security of which no stocks, nor bonds, nor mortgages [were] deposited with the auditor, but that McArthur, etc., caused said notes to be printed and engraved, and then issued as the notes of said bank, well knowing at the same time that such an issue was unauthorized, and in violation of the charter, and that this act was a fraud upon the persons to whom said notes were delivered, and of all others into whose hands they might come. It is alleged that the said notes were made payable to bearer, and on their face contained the promise of said bank to pay the same. They were received and passed in the community as legal notes, and being thus put upon the public they ultimately came, for a valuable consideration, into the hands of the plaintiff.

To this petition the defendant demurred, and assigned the following as causes of demurrer: 1. That the court had no jurisdiction of the case. 2. That there was a deficit of parties defendant. 3. That the petition shows no cause of action. The court overruled the demurrer as to the first and second grounds, but sustained it as to the third, and judgment was rendered for the defendant.

On a subsequent day of the term the judgment was set aside, and the plaintiff offered an amended petition, in substance averring that the notes so issued by the defendant purport to be the notes of said bank, but were not issued by the said bank, and were not the bills or notes of said bank; that they were made and passed by said defendant as a circulating medium, in lieu of and as the representative of money; but were not the notes or bills of any legally incorporated banking institution.

The defendant objected to the filing of the amendment. The court rejected the amendment, and rendered judgment in bar of the action. The plaintiff prayed an appeal.

JUDGE SIMPSON delivered the opinion of the court.

It is not alleged in these cases that the plaintiffs themselves have had any dealings with the defendants or that they received from them the notes which they hold, or that they were deceived with respect to the value of these notes by any misrepresentations or concealment on the part of the defendants. Neither do they allege that they received them in consequence of any inducements held out by the defendants, or any promises made by them that they would be liable for them. They may be regarded, therefore, as having received them as the notes of the corporation, which they purported to be, looking to it for their payment, and relying upon its liability for the amount of them.

The only question, therefore, that arises upon this state of case is, has the board of directors made themselves personally liable for these notes to the holders thereof, by exceeding the authority which the charter conferred upon them, in issuing and putting them into circulation as the notes of the corporation, it having been heretofore decided by this court, in the case of *Watson* v. *The Bank*, that they were issued without authority?

The directors are the agents of the corporation, and derive their powers not from the corporators but from the charter, and cannot bind their principal beyond it. The charter did not authorize them to issue the notes held by the plaintiffs, nor is the corporation bound for them as its notes, although we suppose that it is liable for the amount of them so far as it received, and used any of the benefits or profits derived from them. The holders may have a right to look to the general assets of the corporation, although they have no claim upon the fund set apart for the redemption of those notes which were issued in the manner prescribed by the charter.

It is a general principle, that where a person undertakes to do an act as an agent of another, and exceeds the authority delegated to him, he will be personally responsible therefor to the person with whom he is dealing; but this liability is founded upon the supposition, that the want of authority is unknown to the other party.

A distinction has been taken between acts of an agent for his prin-

cipal in common cases, and similar acts done by the servants or officers of a corporation. In the first case it is said the extent of the authority is known only between the principal and agent, whereas, in the latter the authority is created by statute, to which all may have access who deal with the officers. *Salem Bank* v. *Gloucester Bank*, 17 Mass. Rep. 29; Angel & Ames on Corporations, § 299.

According to this doctrine it was the duty of those dealing with the officers of the corporation to know the extent of their powers, and to know whether the notes held by the plaintiffs were legally or illegally put into circulation. If they received them, knowing that they had been issued without authority, they cannot hold the officers personally responsible for them, inasmuch as the liability of the agent is founded upon the want of knowledge by the other party that he has exceeded his authority. The notes not having been stamped "secured by the pledge of state bonds and real estate," as required by the charter, carried on their face intrinsic evidence of the fact that they had not been lawfully issued, evidence which was visible to all persons, and which all persons receiving them were bound to notice.

Is the position correct, that it is the duty of those who deal with the officers of a bank to know the extent of the power conferred upon them by the charter under which they profess to act? We think it is as a general proposition. Although such corporations are private, yet as their notes are intended for general circulation, and the acts by which they are created are made public, and are of general interest, they do not properly fall under the denomination of private statutes, but must be classed with those that are general and public, or at least they should be considered as *quasi* public acts. The public, therefore, is as much bound to take notice of their provisions as they are to know the provisions of any of the statutes passed by the legislature.

It is a general rule that a party cannot rely upon his own ignorance of such matters, as it was his duty to know, and which he could have known by the use of reasonable diligence. If, for instance, an agent should refer the party with whom he was dealing to a recorded power of attorney as showing the extent of his authority, the latter could not hold the former liable on the ground that he had exceeded his authority in contracting in the name of his principal.

Here the charter containing the powers under which the officers acted was published, and made accessible to all persons. Ignorance of its provisions must, according to well settled legal principles, be considered willful and inexcusable. Knowledge of them discharges the officers from all liability for having exceeded their authority, and as no other ground of liability is made out by the plaintiffs their action cannot be maintained according to the well settled principles of law by which such cases are governed.

It might, as a matter of public policy, be right to hold the officers of a corporation personally responsible whenever they transcended the powers conferred upon them by their charter, to the injury of the public. But, if such a liability be proper, it should be imposed by the terms of the charter, or by some general statute alike applicable to all corporations.

The defendants may have made themselves responsible to those persons with whom they had immediate dealings, if they were guilty of any fraudulent misrepresentations or concealments, but not being liable on the ground of a mere excess of authority, and the plaintiffs not having had any dealings with them, have not made out any valid cause of action against them.

Wherefore, the judgments are affirmed.

NOTE. — See, *accord*, *Abeles* v. *Cochran*, 22 Kan. 405. See also *Humphrey* v. *Jones*, 71 Mo. 62.

In *Nicollet National Bank* v. *Frisk-Turner Co.*, 71 Minn. 413, the plaintiff sold, in form, to a corporation goods which it was *ultra vires* for it to buy. The stockholders in such a corporation were, as such, under a certain liability defined by the constitution. It was held that this did not make them individually liable to the plaintiff for the goods sold. This would seem to be plain on the ground that the liability in question was a liability only for claims for which the corporation was liable. But the court used this language (p. 420): "The articles in question were duly recorded in the office of the register of deeds of Hennepin county, where the corporation was located, and filed and recorded in the office of the secretary of state, and published in a public newspaper, as required by law. Strangers or third persons are presumed to know the law of the land, and are bound, when dealing with corporations, to know the powers conferred by their charters. *Kraniger* v. *Peoples*, 60 Minn. 94, 61 N.W. 904. The act of the corporation in buying and selling ready-made clothing was not only a direct violation of the law above quoted, but a violation of the articles of its incorporation. But this violation was well known to the plaintiff, from actual knowledge received as to what the corporation was doing and intended to do, as well as from its presumptive knowledge of the contents of the articles so recorded and published, and the law above quoted. The representation of the incorporators was not made upon an apparent authority based upon private papers, to which strangers had no access, but that they were buying and selling, and intended to continue to buy and sell, ready-made clothing in violation of law and their articles of incorporation, which plaintiff, knowing such acts to be unlawful, had no right to rely upon."

In *Thilmany* v. *Iowa Paper-Bag Co.*, 108 Iowa, 357, the court said that the person assuming to act as agent for a corporation "simply

covenants that he has authority to act for his principal, not that the act of the principal is legal and binding. . . . There is no implied warranty by an agent that his principal has authority to make the contract. As a rule that is a question of law, of which each party has equal knowledge."

SEEBERGER v. McCORMICK.

178 Ill. 404. 1899.

Mr. Chief Justice Carter delivered the opinion of the court.

Defendant in error, Leander J. McCormick, brought assumpsit in the superior court of Cook County against the plaintiffs in error, Anthony F. Seeberger and others, as co-partners, to recover rent accruing from August 15, 1893, to May 1, 1895, upon a lease made by McCormick to the Market National Bank of Chicago of a certain office, to be used exclusively for the purposes of a bank. The rent stipulated in the lease was $13,000 per annum, payable $1083.33 monthly. Besides the common counts the declaration contained a special count declaring specially on the written lease. Besides the general issue the defendants below filed special pleas denying their joint liability, but before the issues were made the parties waived a jury and submitted the case to the court for decision upon a written stipulation as to the pleadings and the facts, which was incorporated in the bill of exceptions and which contains the following: "The foregoing facts shall be held to be competent evidence, under the pleadings in this cause, to the same extent that they would be under any form of pleadings, the intention of the parties being, that under the pleadings in this cause the respective parties may establish any cause of action or defense that they could, respectively, establish under any form of pleadings." The lease was set out in full in the stipulation, and showed that it was executed by plaintiff, McCormick, and by the Market National Bank, by Seeberger, as its president, and Cox, its cashier. The defendants were all shareholders and directors of the bank. The bank was organized and incorporated but had not received a certificate of the comptroller of the currency authorizing it to transact a banking business. No such certificate was ever issued, and the organization was abandoned within a few months after its inception, but it and its officers occupied the leased premises from May 1 until August 15, 1893, when the officers of the bank vacated and offered to surrender the premises to McCormick, and upon his refusal to accept such surrender left the key upon his desk. In October following, under another agreement between the lessor and lessee, the lessor took possession of the premises to lease the same upon such terms as might be agreed upon, to avoid as much loss as possible, with the agreement that it was to be without prejudice to

the rights of either party; but the property was not rented, and it remained vacant until the lease was terminated, in 1895, in pursuance of its terms, when McCormick brought suit against the Market National Bank to recover the rent stipulated in the lease, but as the National Banking act provides that "no association shall transact any business, except such as incidental and necessarily preliminary to its organization, until it has been authorized by the comptroller of the currency to commence the business of banking," and as the comptroller had not given such authority, it was held that the bank had no power to enter into the lease, and could be held liable only for use and occupation until the premises were vacated, August 15, 1893. *McCormick* v. *Market Nat. Bank*, 61 Ill. App. 33; 162 Ill. 100; 165 U.S. 538. McCormick then brought this suit for the rent for the rest of the term, against the officers, directors and shareholders of the bank, as before stated. . . .

Considering, then, the case upon the questions of law arising on the record, the judgment of the Appellate Court must rest, and be sustained, if at all, upon one of three legal propositions, and counsel for McCormick insist that it can be sustained upon any one of them: First, that plaintiffs in error are liable to McCormick as co-partners, by virtue of the lease to the bank of which they were directors and by virtue of the agreed facts, the lease failing to bind the bank; or, second, that they are liable on their implied warranty, in acting for the bank, that all the necessary steps had been taken in organizing the bank, so that it was authorized to execute the lease; or, third, that plaintiffs in error are liable to defendant in error in an action on the case for deceit, for falsely assuming an authority which they did not possess and by which he was misled to his injury.

The stipulation, among other things, contains the following: "The said Leander J. McCormick, at the time of the negotiations prior to the execution of said lease and at the time of the execution of said lease, and at the time when said officers of said Market National Bank of Chicago took possession of the demised premises on the 22d day of June, A.D. 1893, understood and believed that said Market National Bank of Chicago was duly and legally organized as a national bank, and that, as such, it was ready to do a banking business, and that it had the power to enter into said lease and the agreements connected therewith, and had no knowledge or information to the contrary until the 15th day of August, A.D. 1893, at which time the officers of the said Market National Bank of Chicago informed said McCormick that said Market National Bank of Chicago had no power to enter into said lease, and offered to surrender to said McCormick said demised premises and said lease, and the said McCormick was then and there informed by the said officers of said Market National Bank of Chicago that said Market National Bank of Chicago had never been authorized by the comptroller of the cur-

rency to commence the business of banking, but nevertheless said McCormick then and there refused to accept such surrender."

As has been seen, the pleadings were sufficiently broadened by the stipulation to sustain a judgment in any form of action which the evidence agreed upon would establish. It is plain, upon principle and authority, that plaintiffs in error cannot be held upon the lease itself, as parties thereto. They are not named as parties to or otherwise in the instrument, and there are no apt words to bind them to its covenants. *Hancock* v. *Yunker*, 83 Ill. 208. But counsel for defendant in error insist that under all of the facts as found, plaintiffs in error are liable as co-partners in assuming to act for and on behalf of the bank as a corporation when the bank had no authority to enter into the contract, and cite *Bigelow* v. *Gregory*, 73 Ill. 197, and *Loverin* v. *McLaughlin*, 161 id. 417. In these cases this court held, in substance, that persons who associate themselves together by articles of agreement to become a corporation, but do not comply with the law so as to become a corporation, will be liable as partners for contracts made by them in the name assumed as the corporate name. In the *Loverin case* they were held liable under the statute of this State, and it was also there said they were liable independently of the statute. But in those cases there was a failure to incorporate, while in the case at bar the lessee, the Market National Bank, was a corporation *de jure*, but was by the act by which it was incorporated incapacitated from transacting the business of banking, or entering into contracts of the character of this lease, until it had received the certificate of the comptroller, which he was not authorized to issue until certain requirements had been complied with, one of which was that one-half of the capital subscribed had been paid in. But the bank had the corporate power to transact such business and make such contracts as were "incidental and necessarily preliminary to its organization." It is not a case where the party to the contract had no corporate power, but one where its corporate power was exceeded, — a case where the contract was not *ultra vires* corporations organized under the law under which it was incorporated, but *ultra vires* this corporation, because it had failed to comply with a certain provision, without compliance with which there was a deficiency of corporate power. Here there was a *de jure* corporation, while in the cases cited there was none. We are disposed to agree with the Appellate Court that the principle on which individuals so associated are held as partners is not in causing the corporation to exceed its powers, but in acting for and in the name of a presumed corporation which has no corporate existence. *Trowbridge* v. *Scudder*, 11 Cush. 83; *First Nat. Bank* v. *Almy*, 117 Mass. 476; *Gent* v. *Manufacturers' and Merchants' Mutual Ins. Co.*, 107 Ill. 652; *Loverin* v. *McLaughlin*, *supra*.

The second proposition of defendant in error is, that plaintiffs in

error, if not liable as partners, are still liable *ex contractu* upon their implied warranty of their authority to execute, or to cause to be executed on behalf of the corporation, the lease in question. The principle is one of agency, and that plaintiffs in error, as the agents of the corporation in making the contract of lease, by necessary implication asserted to the lessor that they were in fact authorized to cause the lease to be executed by the corporation. Where the contract is made in good faith and both parties are fully cognizant of the facts, and the mistake is one of law only, the result of which is to exonerate the principal from liability because the agent had no lawful authority to make the contract, it is clear that the agent cannot be held liable, either *ex contractu* or *ex delicto*. The Appellate Court was authorized to find, and doubtless did find, that this was not such a case. These directors were charged with knowledge that they had not taken the necessary steps to obtain, and had not obtained, the certificate of the comptroller necessary to confer power to make the lease, and it was a fair inference for the Appellate Court to draw from the agreed facts that McCormick did not know of this omission until August 15, 1893, — several months after the lease was executed and after possession of the premises had been taken by the lessee under it. The stipulation also showed that the plaintiffs in error canceled their articles of association in July, but remained in possession of the premises until the 15th day of August. They had by resolution authorized and directed the execution of the lease, and there can be no doubt of the legal sufficiency of the evidence to establish an implied warranty on their part of their authority to enter into the lease on behalf of the corporation, if such implied warranty is in law a sufficient ground on which to make them liable to respond in damages to McCormick for a breach of such warranty.

It is, however, contended by the plaintiffs in error that the law is that there is no such liability *ex contractu*, and that the only remedy is by a special action on the case, and then only when there has been some deception practiced on the opposite party, — some misrepresentation to or concealment from him of some material fact, — and which deception, misrepresentation or concealment operated to induce him to enter into the contract; and we are referred to *Duncan* v. *Niles*, 32 Ill. 532, and *Hancock* v. *Yunker*, 83 id. 208, and the opinion of the Appellate Court in this case, as settling the law to that effect in this State. We do not regard the cases cited as holding that an action *ex contractu* upon the implied warranty cannot be maintained. That question was not in issue in either of the two cases cited, decided by this court. True, it was said that an action on the case for deceit would lie. In the *Duncan-Niles case* the action was brought against Niles on the note which Niles, assuming to act for the county, had given as the note of the county, and it was held that the contract was void and that neither party could be held on it, the

county not having authorized it and there being no apt words in the instrument to bind Niles. It was there said, that "if the defendant falsely represented himself as the agent of the county and authorized to obtain this money, and did so obtain it, he may be reached by a special action on the case for the fraud, *or in some other appropriate action, but not on the note itself.*" And in the *Hancock-Yunker case* the action was covenant on the lease against the individual trustees who executed it on the part of the Chicago Literary Association, and it was held they were not liable on the instrument, it containing no apt words to bind them individually. Mr. Justice SCHOLFIELD, in delivering the opinion of the court, among other things said: "The question here is not whether these defendants may be held liable to the plaintiff *in a proper form of action*, but whether they are liable *in this form of action*, — i.e., covenant upon the lease." True, the opinion contains the quotation in the *Duncan-Niles case* from *Abbey* v. *Chase*, 6 Cush. 56, that in Massachusetts the only remedy against the agent is by action on the case for falsely assuming to act as agent; but those cases cannot be treated as having decided that an action in assumpsit, not on the instrument itself but on the implied warranty of authority to execute it, cannot be maintained in this State. We are of the opinion that upon both principle and authority such an action can be maintained. Indeed, the fraud, if any, arises out of the contractual relations which the parties have assumed. The express contract purporting to bind the principal may be void, but if the agent has given his warranty, express or implied, that he is authorized by his principal to execute the contract when he has no such authority, we know of no principle of law or logic which would prevent the other party from recovering for the breach of such warranty where injury has been sustained by such breach. Why may he not waive the tort, where tort exists, and sue in assumpsit? That an action *ex contractu* on the implied warranty will lie, has been decided by many authorities. Mechem on Agency, § 549; 1 Am. & Engl. Ency. of Law (2d ed.) 1127; Anson on Contracts, p. 460; *Mahurin* v. *Harding*, 28 N.H. 128; *Collen* v. *Wright*, 7 E. & B. 301; *Cherry* v. *Colonial Bank*, L.R. 3 Privy Council App. 24; *Downman* v. *Williams*, 7 Q.B. 111; *Beattie* v. *Lord Ebury*, 7 Eng. & Irish App. H.L. 102; *Lewis* v. *Nicholson*, 18 A. & E. 502; Story on Agency, § 264; *Patterson* v. *Lippincott*, 47 N.J.L. 457; *White* v. *Madison*, 26 N.Y. 117; *Richardson* v. *Williamson*, L.R. 6 Q.B. 276.

Doubtless, in many cases a recovery may be had in either form of action, but in others the character of the suit must be determined by the facts of the case. Thus it is said in Mechem on Agency, § 549: "Much question has been raised as to the form of action in which the agent who acts without authority is to be held liable, — whether an assumpsit can be maintained or only a special action on the case. It would seem that this is a question to be determined largely by

the particular facts of each case. Where an agent who knows that he has no authority makes express assertions that he possesses it, or so acts as to amount to an assertion of authority, and by so doing deceives and injures the other party who has relied thereon, it cannot be doubted that an action on the case for the deceit is an appropriate remedy. At the same time, an action of assumpsit upon the express or implied warranty of authority might also be maintained instead of the action on the case."

As the record in this case shows a clear right of action for a breach of the implied warranty of authority against the plaintiffs in error, we deem it unnecessary to decide whether or not the findings of fact by the Appellate Court would sustain an action on the case for deceit.

NOTE. — In *McCormick* v. *Market Bank*, 165 U.S. 538, in which it was held that no recovery of the rent reserved could be had against the corporation, the court, by Mr. Justice GRAY, said (p. 551): "The result of the Comptroller's examination, and his certificate of that result, and of the authority thereupon granted the corporation to commence the business of banking, of course appear on the records of his office, as do the articles of association and the organization certificate previously transmitted to him. Every one dealing with the corporation is bound to take notice of the facts thus appearing on a public record, upon which, by the very terms of the National Bank Act, depend the right of the association to exist as a corporation, and its capacity to transact business."

In *Seeberger* v. *McCormick*, 175 U.S. 274, the principal case having been carried to the Federal Supreme Court, the writ of error was dismissed on the ground that no federal question was presented.

For other authorities that liability may be cast upon human beings see *Vliet* v. *Simanton*, 63 N.J.L. 458, 464; *Medill* v. *Collier*, 16 Ohio St. 599; *Trust Co.* v. *Floyd*, 47 Ohio, 525; *Small* v. *Elliott*, 12 S.D. 570.

F. Setting Aside an Ultra Vires Transaction.

ST. LOUIS RAILROAD *v.* TERRE HAUTE RAILROAD.

145 U.S. 393. 1892.

Bill in equity, filed in 1887, by an Illinois corporation against an Indiana corporation, to set aside and cancel a conveyance, or lease, of the plaintiff's railroad and franchises to the defendant for a term of 999 years. The lease was made in 1868. The defendants took possession of the road shortly after the execution of the lease, and have ever since operated it. The bill, as amended, prayed for a cancellation and surrender of the lease, for a return of the railroad and other property held under it, for an injunction against disturbing the plaintiff in the possession and control thereof, and for an account of the sums which the defendant had received, or with due diligence might have received, from the use and operation of the railroad and property.

Gray, J. . . . It may therefore be assumed, as contended by the plaintiff, that the contract in question was *ultra vires* of the defendant, and therefore did not bind either party, and neither party could have maintained a suit upon it, at law or in equity, against the other.

It does not, however, follow that this suit to set aside and cancel the contract can be maintained. If it can, it is somewhat remarkable that, in the repeated and full discussions which the doctrine of *ultra vires* has undergone in the English courts within the last fifty years, no attempt has been made to bring a suit like this. The only cases cited in the elaborate briefs for the plaintiff, or which have come to our notice, approaching this in their circumstances, are in American courts not of last resort, and present no sufficient reasons for maintaining this suit. *Auburn Academy* v. *Strong*, Hopkins Ch. 278; *Atlantic & Pacific Telegraph Co.* v. *Union Pacific Railway*, 1 McCrary, 541; *Western Union Telegraph Co.* v. *St. Joseph & Western Railway*, 1 McCrary, 565; *Union Bridge Co.* v. *Troy & Lansingburgh Railroad*, 7 Lansing, 240; *New Castle Railway* v. *Simpson*, 21 Fed. Rep. 533.

The English cases relied on by the plaintiff were either suits to set aside marriage brokage bonds, as in *Drury* v. *Hooke*, 1 Vernon, 412, and *Smith* v. *Bruning*, 2 Vernon, 392; *S. C. nom. Goldsmith* v. *Bruning*, 1 Eq. Cas. Ab. 89; or to recover back money paid for the purchase, without leave of the Crown, of a commission in the military or naval service, as in *Morris* v. *McCullock*, Ambler, 433; *S. C.* 2 Eden, 190. Those cases have sometimes been justified upon the ground that, the agreement being against the policy of the law, the relief was given to the public through the party. *Debenham* v. *Ox*,

1 Ves. Sen. 276; *St. John* v. *St. John*, 11 Ves. 526, 536; *Cone* v. *Russell*, 3 Dickinson (48 N.J. Eq.) 208. But Sir William Grant explained them as proceeding upon the ground that the plaintiff was less guilty than the defendant. *Osborne* v. *Williams*, 18 Ves. 379, 382. And *Morris* v. *McCullock* can hardly be reconciled with his decision in *Thomson* v. *Thomson*, 7 Ves. 470, or with the current of later authorities.

The general rule, in equity, as at law, is *In pari delicto potior est conditio defendentis;* and therefore neither party to an illegal contract will be aided by the court, whether to enforce it or to set it aside. If the contract is illegal, affirmative relief against it will not be granted, at law or in equity, unless the contract remains executory, or unless the parties are considered not in equal fault, as where the law violated is intended for the coercion of the one party and the protection of the other, or where there has been fraud or oppression on the part of the defendant. *Thomas* v. *Richmond*, 12 Wall. 349, 355; *Spring Co.* v. *Knowlton*, 103 U.S. 49; Story Eq. Jur. § 298.

While an unlawful contract, the parties to which are *in pari delicto*, remains executory, its invalidity is a defence in a court of law; and a court of equity will order its cancellation only as an equitable mode of making that defence effectual, and when necessary for that purpose. Adams on Eq. 175. Consequently, it is well settled, at the present day, that a court of equity will not entertain jurisdiction to order an instrument to be delivered up and cancelled, upon the ground of illegality appearing on its face, and when, therefore, there is no danger that the lapse of time may deprive the party to be charged upon it of his means of defence. Story Eq. Jur. § 700*a*, and cases cited; *Simpson* v. *Howden*, 3 Myl. & Cr. 97; *Ayerst* v. *Jenkins*, L.R. 16 Eq. 275, 282.

When the parties are *in pari delicto*, and the contract has been fully executed on the part of the plaintiff, by the conveyance of property, or by the payment of money, and has not been repudiated by the defendant, it is now equally well settled that neither a court of law nor a court of equity will assist the plaintiff to recover back the property conveyed or money paid under the contract. *Thomas* v. *Richmond*, above cited; *Ayerst* v. *Jenkins*, L.R. 16 Eq. 275, 284. For instance, property conveyed pursuant to a contract made in consideration of the compounding of a crime, and the stifling of a criminal prosecution, and therefore clearly illegal, cannot be recovered back at law, nor the conveyance set aside in equity, unless obtained by such fraud or oppression on the part of the grantee, that the conveyance cannot be considered the voluntary act of the grantor. *Worcester* v. *Eaton*, 11 Mass. 368, and 13 Mass. 371; *Atwood* v. *Fisk*, 101 Mass. 363; *Bryant* v. *Peck & Whipple Co.*, 154 Mass. 460; *Williams* v. *Bayley*, L.R. 1 H.L. 200; *Jones* v. *Merionethshire Society*, 1892, 1 Ch. 173, 182, 185, 187.

In the case at bar, the contract by which the plaintiff conveyed its railroad and franchise to the defendant for a term of nine hundred and ninety-nine years was beyond the defendant's corporate powers, and therefore unlawful and void, of which the plaintiff was bound to take notice. The plaintiff stood in the position of alienating the powers which it had received from the State, and the duties which it owed to the public, to another corporation, which it knew had no lawful capacity to exercise those powers or to perform those duties.

If, as the plaintiff contends, the contract was also beyond its own corporate powers, it is certainly in no better position. In either aspect of the case, the plaintiff was *in pari delicto* with the defendant. The invalidity of the contract, in view of the laws of which both parties were bound to take notice, was apparent on its face. The contract has been fully executed on the part of the plaintiff by the actual transfer of its railroad and franchise to the defendant; and the defendant has held the property, and paid the stipulated consideration from time to time, for seventeen years, and has taken no steps to rescind or repudiate the contract.

Upon this state of facts, for the reasons above stated, the plaintiff, considered as a party to the unlawful contract, has no right to invoke the assistance of a court of equity to set it aside. And so far as the plaintiff corporation can be considered as representing the stockholders, and seeking to protect their interests, it and they are barred by laches. *Harwood* v. *Railroad Co.*, 17 Wall. 78; *Graham* v. *Birkenhead &c. Railway*, 2 Hall & Twells, 450; *S. C.* 2 Macn. & Gord. 146; *Ffooks* v. *Southwestern Railway*, 1 Sm. & Gif. 142, 164; *Gregory* v. *Patchett*, 11 Law Times (N.S.) 357.

This case is not like those in which the defendant, having abandoned or refused to perform the unlawful contract, has been held liable to the plaintiff, as upon an implied contract, for the value of what it had received from him and had no right to retain. *Spring Co.* v. *Knowlton*, 103 U.S. 49; *Logan County Bank* v. *Townsend*, 139 U.S. 67, and cases there cited.

But the case is one in which, in the words of Mr. Justice Miller in a case often cited in this opinion, the court will not disturb the possession of the property that has passed under the contract, but will refuse to interfere as the matter stands. *Pennsylvania Railroad* v. *St. Louis, Alton & Terre Haute Railroad*, 118 U.S. 290, 316, 317. See also *Union Trust Co.* v. *Illinois Midland Co.*, 117 U.S. 434, 468, 469; *Central Transportation Co.* v. *Pullman's Car Co.*, 139 U.S. 24, 56, 57, 61.

Decree affirmed.

Note. — In the *Central Transportation case, supra,* Mr. Justice Gray reasoned that the corporation could not make the lease. In the principal case, he reasoned that the corporation is a guilty party because it has made the lease.

If the objection to the *ultra vires* lease was, as stated in the *Central Transportation case*, "not merely that the corporation ought not to have made it, but that it could not make it," it would seem to follow that the act of making the lease was simply the act of certain human beings to which no corporate significance could be given; that the lease was a cloud upon the plaintiff's title; and that it was entitled to a declaration to that effect, with the relief properly predicated upon such a declaration.

See *Memphis R.R. Co.* v. *Grayson*, 88 Ala. 572, 578.

HARRIS *v.* GAS CO.

76 Kan. 750. 1907.

MASON, J. Cornelius Carr and his wife executed to the Independence Gas Company an oil-and-gas lease; that is, an instrument granting the right to explore a tract of land for oil or gas and to appropriate either if found. The company is a Kansas corporation and at the time of the execution of the lease the only purpose mentioned in its charter was "to dig or mine for natural gas and sell the same for heat and lighting purposes." Later an amendment was made adding thereto the mining and selling of oil. What are called the "gas rights" under the lease have been transferred to another gas company and no point is raised with regard to them. The Carrs, claiming that the lease so far as it related to oil was void because at the time it was executed the lessee had no authority to engage in the oil business, undertook to grant the oil privileges anew to C. C. Harris, who upon that ground brought a suit against the Independence Company to cancel all of its contract excepting that portion relating to gas, joining his grantors as co-plaintiffs. The trial court sustained a demurrer to a petition setting out substantially these facts and this proceeding is brought to review that ruling.

The defendant maintains: (1) That it had the implied power to produce and market oil as an incident to the express power granted to it to produce and market gas; (2) that if it originally lacked such power the defect was supplied by the charter amendment; and (3) that even if it had no authority to enter into the contract the plaintiffs cannot take advantage of the fact. It will only be necessary to consider the questions involved in the third proposition.

Although the decisions relating to the doctrine of *ultra vires* are characterized by some confusion as well as by much conflict, they admit of classification into fairly well-defined groups and exhibit a development in the direction of restricting the scope of its operation. Those courts which accord it the most favorable treatment — allow it the largest field of action — proceed upon the conception that a

corporation, being the creature of the state, possesses no power whatever beyond that granted in its charter, and cannot directly or indirectly acquire rights or incur liabilities under any contract not thereby authorized. They refuse under any circumstances to enforce or give effect to an unauthorized contract, as such, but where it has been acted upon will protect the parties against hardship and injustice by allowing whatever relief may be suited to the facts of the case; for instance, by permitting either party to recover money or property which has been parted with in the transaction, or to have compensation therefor. The cases illustrating this treatment of the matter are collected in volume 29 of the American and English Encyclopædia of Law, at page 54, note 2. The theory is consistent and logical, but its practical effect is so to circumscribe the power of the court as to make the relief furnished at times inadequate to the occasion.

In a larger number of jurisdictions, although the same conception of corporate capacity is adopted, its effect is greatly changed by the application of another principle. Here the courts concede that a corporation has no power to make a contract except such as is conferred by its charter, expressly or by necessary implication. But they hold that as it must have some discretion in the manner of carrying out the purposes of its creation — some freedom of action — it is amenable to the same rules of conduct as a natural person, and may estop itself to question the validity of an agreement it has assumed to make, or may acquire the right to invoke a similar estoppel in its own behalf. Where this theory is accepted recovery may be had upon a contract which is in fact void, simply because its validity cannot be put in issue. The cases in point are gathered in volume 29 of the American and English Encyclopædia of Law, at page 57, note 1.

These cases have been criticised for the use they make of the word "estoppel" as descriptive of the principle upon which they are based. It is argued that as a corporation must know the terms of its own charter, and as one dealing with it is charged with like knowledge, neither party to an *ultra vires* contract can be misled in that respect, and therefore there must always be lacking an essential element of what could with technical accuracy be called estoppel. This, however, is a mere question of terminology. The requirement that one shall be consistent in conduct — shall not occupy contradictory positions — shall not retain the advantages of a transaction and reject its burdens — is often spoken of as a form of estoppel. The term is convenient, and, if inaccurate, is not misleading. This rule of estoppel affords a good working hypothesis to accomplish just results. If it fails to accomplish all that might be desired in a practical way it is because it is not made sufficiently far-reaching. It is generally held to be inapplicable to purely executory contracts, one

reason stated being that "where neither party has acted upon the contract, the only injustice caused by a refusal to enforce it is the loss to the parties of prospective profits, and this is too slight a consideration to weigh against the reasons of public policy for declaring it void and not enforceable." 29 A. & E. Encycl. of L. 49.

It might seem reasonable that a system which attempts not only to protect a party to an *ultra vires* contract from actual loss, but, where equity requires it, to insure to him the actual fruits of his bargain, ought for the sake of completeness and symmetry to enable him to insist upon the performance even of a purely executory contract. It certainly seems against conscience that one who has entered into a contract in the expectation of deriving a profit from it may upon discovering the probability of a loss repudiate it and escape responsibility by raising the question of want of corporate capacity. Parties to a contract who deal with each other upon the assumption that one of them is a corporation are ordinarily precluded from questioning the validity of its organization.

The question whether a corporation has power under its charter to engage in a particular business is so like the question whether a body has capacity to act as a corporation at all as to afford good ground for arguing that whatever circumstances work an estoppel to raise the one have the same effect with respect to the other. This is recognized in volume 10 of the Cyclopedia of Law and Procedure, at page 248, where it is said: "A person contracting with an ostensible corporation to do an act which is not prohibited by law becomes estopped, in an action by the corporation to enforce the contract, either to deny the existence of the corporation or its power to enter into such a contract." (¶ *i.*)

The cases cited in support of this text, however, arose upon executed contracts, and we do not discover that the principle has actually been applied in actions upon purely executory agreements, unless where the question sought to be raised was whether a body assuming to act as a corporation had a legal existence as such. Nevertheless, no good ground is apparent for a distinction in this regard. . . .

The question whether a corporation has a legal existence is a question whether it has capacity to act at all. This is essentially of the same character as the question whether it has capacity to enter into a particular contract — in other words, whether it has a legal existence for that purpose. The State grants the corporation the right to do business under limitations expressed in language to which both agree. Whether the language of the charter shall be interpreted to authorize a given act is a matter between the parties to it. If the State is satisfied with the construction upon which the corporation acts no reason is apparent why it should be open to question by a stranger, much less by one who has recognized it as valid by contracting with the corporation upon that basis.

No Kansas statute declares that a contract made by a corporation in excess of its legitimate powers shall be void, or in terms permits the question of corporate capacity to be raised by one of the parties. Where it is held that no recovery can ever be had upon an *ultra vires* contract, as such, whatever relief is afforded is logically made to turn upon whether and how far the agreement has been acted upon. Where a recovery is sometimes permitted under the contract itself, upon the principle of estoppel, the question whether it has been carried out is likewise of manifest importance, there being a difference in degree at least between the attitude of one who has merely entered into an engagement in expectation of obtaining an advantage from it and that of one who has actually reaped its benefits in whole or in part. But the doctrine that only the state can challenge the validity of acts done under color of a corporate charter, if accepted, must necessarily protect an executory contract from collateral attack equally with one that has been executed. The court is convinced of the soundness of the view that in the absence of special circumstances affecting the matter neither party to even an executory contract should be allowed to defeat its enforcement by the plea of *ultra vires.* The doctrine is logical in theory, simple in application, and just in result. It of course does not apply to contracts which are immoral or which are illegal, as distinguished from merely unauthorized, or to those made by public corporations. Nor does it forbid interference by a stockholder to protect his rights as such.

Upon these considerations the judgment is affirmed.

NOTE. — In *Railroad Co.* v. *Railroad Co.*, 196 Pa. 452, a lease of railroad property, *ultra vires* of the parties, was treated as the foundation of rights between the parties, and the court refused to set it aside, at the instance of the lessor.

In *Camden and Atlantic R.R. Co.* v. *Mays Landing R.R. Co.*, 48 N.J.L. 530, railroad corporation M agreed that, if a certain branch line were built by railroad corporation N, it would guarantee the bonds of N, and take a lease of the line for 999 years at a specified rental. It was *ultra vires* of M to make such an agreement. The road was built, the bonds of N guaranteed, the lease executed, and M took possession. Later it abandoned possession, and gave notice of such fact to N. M paid the rent for the full period during which it was in possession. This action was brought to recover rent thereafter accruing, and the court, by a vote of 11 to 3, allowed N to recover. The facts showed acquiescence in the transaction by the stockholders (p. 571). The court regarded the transaction as in substance equivalent to a conveyance of the branch line to M, in consideration of the issue of M's obligations, and therefore an executed transaction which would be a foundation of rights between the parties until the state intervened.

It would seem plain from *Thomas* v. *Railroad Co.*, 101 U.S. 71, and the cases founded on the *Central Transportation case, supra*, that, in the federal courts, where there is, in form, a lease of railroad property, which lease is *ultra vires* of the lessor, or lessee, or both, the lessee may at any time abandon the possession, and thereby prevent any further liability from accruing against it. What can the lessor do? *St. Louis R.R. Co.* v. *Terre Haute R.R. Co., supra,* bars avoidance, through court help. Suppose the lessor seeks to resume possession by self-help. Will the court protect the lessee by an injunction? This was done by an inferior federal court in *American Union Telegraph Co.* v. *Union Pacific R.R. Co.*, 1 McCrary, 188; but this case was cited, with disapproval, in *St. Louis R.R. Co.* v. *Terre Haute R.R. Co.*

For cases holding that an absolute transfer of property could not be set aside, on the ground that it was *ultra vires* of one, or both, of the parties, see cases cited in the note to *Kerfoot* v. *Farmers Bank, supra.*

For other cases in which the courts have treated *ultra vires* transactions as not being voidable, see *First Presbyterian Church* v. *State Bank*, 57 N.J.L. 27; *Pannebaker* v. *Tuscarora R.R. Co.*, 219 Pa. 60.

For authorities holding that, under certain circumstances, stock improperly issued may be cancelled, see cases cited in the note to *Old Dominion Copper Co.* v. *Bigelow, supra* (pp. 373–377).

BOOK VI.

OFFICERS, STOCKHOLDERS, AND CREDITORS.

CHAPTER I.

DIRECTORS AND OTHER OFFICERS.

A. Unauthorized Action by de jure Officers.

ROYAL BRITISH BANK *v.* TURQUAND.

6 E. & B. 327. 1856.

The plaintiffs declared against the defendant, as official manager of Cameron's Coalbrook Steam, Coal, and Swansea and London Railway Company, according to The Joint-Stock Companies Winding-up Acts (the company being completely registered under Stat. 7 & 8 Vict. c. 110). The declaration alleged that the company, before defendant became official manager, to wit, on 6th March, 1850, by their writing obligatory, sealed with their common seal, acknowledged themselves to be held and firmly bound to plaintiffs in 2000*l.*, to be paid to plaintiffs on request; for which payment the said last-mentioned company did bind themselves and their successors. Yet the said sum, or any part thereof, has not been paid.

Plea (1), in which was set out the condition, which appeared to be for securing to the plaintiffs, who were bankers, such sum as the company should, to the amount of 1000*l.*, owe to plaintiffs on the balance of the account current, from time to time, and for indemnifying plaintiffs to that amount from losses incurred by reason of the account between plaintiffs and the company. The plea further set out clauses of the registered deed of settlement of the company, by which it appeared that the directors were authorized, under certain circumstances, to give bills, notes, bonds, or mortgages; and one clause provided that the directors might borrow on bonds such sums as should, from time to time, by a general resolution of the company, be authorized to be borrowed. The plea averred that there had been no such resolution authorizing the making of the bond, and that the same was given and made without the authority or consent of the shareholders of the company.

The plaintiff demurred to the plea, and Jervis, C.J., said on this point: —

It seems to us that the plea, whether we consider it as a confession

and avoidance or a special *Non est factum*, does not raise any objection to this advance as against the company. We may now take for granted that the dealings with these companies are not like dealings with other partnerships, and that the parties dealing with them are bound to read the statute and the deed of settlement. But they are not bound to do more. And the party here, on reading the deed of settlement, would find, not a prohibition from borrowing, but a permission to do so on certain conditions. Finding that the authority might be made complete by a resolution, he would have a right to infer the fact of a resolution authorizing that which on the face of the document appeared to be legitimately done.

NOTE. — See, *accord*, *In re Hampshire Land Co.*, [1896] 2 Ch. 743, where the meeting of shareholders at which the directors were authorized to borrow was not properly called.

Buckley on Companies, 8th ed. p. 570, cites this case as an authority for the proposition that "a stranger dealing with a company has a right to assume, as against the company, that all matters of internal management have been complied with."

This is a large proposition. If the president of a company contracts, in behalf of the company, with A, and the company has power to make such a contract, is the company bound, without more? The act of the directors in giving authority to the president would seem to be a matter of internal management.

Again. If a person, who is not president of a company but who assumes to be, makes such a contract in behalf of the company with A, is the company bound without more? The election of a president would also seem to be a matter of internal management.

In *Duck* v. *Tower Galvanizing Co., Ltd.*, [1901] 2 K.B. 314, a debenture was issued in the name, and under the seal, of the company by persons who assumed to be directors but who were not directors. The court held that "from the case of *Royal British Bank* v. *Turquand* down to *Mahony* v. *East Holyford Mining Co.*, L.R. 7 H.L. 869, in the House of Lords, it has always been held that it is not incumbent on the holder of such a document purporting to be issued by a company to inquire whether the persons pretending to sign as directors have been duly appointed. . . . The memorandum of association allowed the company to borrow money on debentures, and the articles of association of the company might very well have justified the issuing of such a debenture as this." The facts of the case show that a person with a small business formed a limited company and conveyed his business to it, and thereafter carried on the business in the name of the company, without consulting the other incorporators, and that the debenture was issued, with his approval, for an advance made to the company. The decision that the company was bound may well be supported, but, it is submitted, the proposition stated by the court is too broad.

In the United States, the principal case was followed in *Louisville Ry. Co.* v. *Louisville Trust Co.*, 174 U.S. 552. The directors of a corporation were authorized to guarantee bonds of another corporation, upon the petition of the majority of the stockholders. They caused the guaranty to be made in the corporate name, although there had been no such petition. It was held that the guaranty was enforceable by a person who purchased the bonds without notice of this defect. "The records of the railroad corporation and of its board of directors, which would naturally show whether such a petition had or had not been filed, were private records, which a purchaser of the bonds was not obliged to inspect, as he would have been if the fact had been required by law to be entered upon a public record."

In *Commissioners of Knox County* v. *Aspinwall*, 21 How. (U.S.) 539, one ground of decision was that an express representation by certain officials that certain acts had been done was binding upon the municipal corporation in question.

The principal case may be explained as deciding (1) that a representation by the directors that certain acts have been done binds the corporation; and (2) that if the directors are authorized to do an act, only when certain conditions precedent have been satisfied, their doing the act is, without more, a representation that the conditions precedent have been satisfied.

There is authority reaching a result opposite to that reached in the principal case, even when so explained. In *McShane* v. *Carter*, 80 Cal. 310, it was held that the act of directors in making a conveyance of corporate property did not bind the corporation. The statute required that the holders of two-thirds of the capital stock should assent, and there had been no such assent. See also *Williams* v. *Gaylord*, 186 U.S. 157.

It is submitted that the large proposition laid down by Buckley as to "matters of internal management" is not law in the United States. See chapter II of Book III, *supra*.

But certain minor propositions with regard to matters of internal management have been established in this country.

1. Where *de jure* directors have acted on a matter within their authority, their action will be presumed to be according to law, in the absence of proof to the contrary. *Barrell* v. *Lake View Land Co.*, 122 Cal. 129; *Sargent* v. *Webster*, 13 Metc. (Mass.) 497; *Mining Co.* v. *Anglo-Californian Bank*, 104 U.S. 192.

2. Where *de jure* directors have authorized an act to be done by the executive officers, and this act is done, but not in the mode indicated in the by-laws, and the irregularity was unknown to the outsider, the corporation is bound. *Smith* v. *Smith*, 62 Ill. 493.

3. Where *de jure* directors have authorized an act to be done, but the meeting of the directors was held in an improper place, and the irregularity was unknown to the outsider, the corporation is bound. *Galveston R.R.* v. *Cowdrey*, 11 Wall. (U.S.) 459.

B. De Facto Officers.

KUSER *v.* WRIGHT.

52 N.J. Eq. 825. 1894.

Van Syckel, J. The Ott & Brewer Company was organized under the laws of this State, with three directors, viz., Brewer, Tucker, and Bell.

In June, 1891, Bell made an assignment for the benefit of creditors, and soon after that left the State.

In November, 1891, the Ott & Brewer Company, by the two directors, Brewer and Tucker, executed a mortgage on its real estate and certain goods and chattels, to the First National Bank of Trenton, to secure a preëxisting indebtedness. This mortgage was recorded as a real estate mortgage, but was not sworn to or recorded as a chattel mortgage.

In August, 1892, the said company, by the same two directors, executed three several chattel mortgages to Anthony R. Kuser, John L. Kuser, and Albert Brewer respectively, to secure to each of them the sum of $5000, at that time loaned by them to the said company.

In May, 1893, a bill was filed in the court of chancery, alleging that the said "The Ott & Brewer Company" was insolvent, and thereupon John Wright was appointed receiver of the said company.

The receiver exhibited his bill to set aside all these mortgages.

The alleged infirmity, chiefly relied upon, is that two directors had no power to establish a lien upon the property of the corporation.

Our act concerning corporations, section 16, provides —

"That the business of every such corporation shall be managed and conducted by the directors thereof, who shall respectively be shareholders therein."

Section 17 provides: —

"The directors shall not be less than three in number, and they shall be chosen annually by the stockholders at such time and place as shall be provided by the by-laws of the company, and shall hold their office for one year, and until others are chosen and qualified in their stead."

Section 20 provides that —

"when any vacancy occurs among the directors, or secretary, or treasurer, by death, resignation, removal, or otherwise, it shall be filled for the remainder of the year in such manner as may be provided for by the by-laws of the said company."

Section 47 provides that —

"it shall not be lawful for any person to be elected a director of any

body corporate in this state issuing stock unless that person shall be, at the time of his election, a *bona fide* holder of some of the stock thereof."

Section 48 provides that —

"when any person, a director of any body corporate, shall cease to be a *bona fide* holder of some of the stock thereof, he shall cease thereupon to be a director thereof."

The point made against these mortgagees is that under our statute there must be at least three directors to manage the corporate business; that by the assignment made by Bell for the benefit of his creditors he ceased to be a stockholder, and by force of the statute ceased at the same time to be a director of the company, thereby leaving the corporation without a board of directors legally qualified to conduct its affairs.

That such a result justly or legally flows from these premises cannot be conceded. It is apparent that dealing with these corporate bodies would be in the highest degree hazardous and unsafe if the public, without notice in fact, is chargeable in law with knowledge of a latent infirmity in the title of every director of the company. A doctrine so destructive to the security of commercial transactions, now so largely conducted by corporate action, has no support in the law. The receiver stands for the corporation, and cannot impeach any act which the corporation itself could not successfully assail.

Bell's original title to the office of director was good; it is not denied that he was legally elected. The corporation held him out to the public as one of its duly-authorized agents by failing to declare his office vacant and electing his successor.

In *Doremus* v. *The Dutch Reformed Church*, 2 Gr. Ch. 349, Chancellor VROOM said "that where the original title of an officer is sufficient, though good cause of amotion be shown, even in a case where the charter declares that for such cause of amotion the officer shall vacate his office, the office is not determined until there be an amotion."

He also said "that where persons are officers *de facto* they are *in colore officii*, and their acts will be valid until they are lawfully ousted, and more especially as they respect third persons they are binding on the corporation."

The authorities are cited in the opinion.

This rule has never been departed from in this State.

Vice-Chancellor VAN FLEET, in *Mechanics' Bank* v. *Burnet Company*, 5 Stew. Eq. 236, adopted it. He there declares "that if the officers selected are ineligible or are elected irregularly or illegally, but are allowed by the proprietors of the corporation to take control of its property, and to exercise its functions and powers, they become officers *de facto*, and as such may act for and bind the corporation. An officer *de facto* is one who has the reputation of being

the officer he assumes to be, and yet is not a good officer in point of law.

"From a very early time it has been held that the acts of *de facto* officers are binding upon the corporation until they are lawfully ousted, especially so far as their acts create rights in favor of third persons."

That such is the current of authority will appear by reference to the books. *Mining Company* v. *Bank*, 104 U.S. 192; Beach Corp. §§ 233, 234; Ang. & A. Corp. § 287.

In *San-Jose Savings Bank* v. *Sierra Lumber Company*, 63 Cal. 179, a director who had ceased to be a stockholder, no judgment of ouster having been pronounced against him, was held to be a director *de facto*, and his acts valid as to third persons.

Mr. Taylor, in his book on Private Corporations, §§ 187, 188, after stating the rule as formulated in the cases above cited, says that —

"It is submitted that this statement of the rule does not give sufficient prominence to the principle of estoppel, on which the rule depends; a principle which, in its application to the responsibility of corporations for the acts of *de facto* officers, may be stated thus: If a body of men, acting as a corporation, permits certain persons to act openly as corporate officers, or if it is permitted by the directors, assuming them to have had the power to appoint the officer in question, the corporation will not, to the detriment of persons who, in good faith, have acted on the assurance that the persons acting as officers were the officers they assumed to be, be permitted to impeach the validity of their acts and contracts on the ground that such persons were not legally corporate officers."

Bottomley's Case, L.R. 16 Ch. Div. 681, is not in conflict. In that case the contest was between the company and its own stockholders. Five directors were necessary to conduct the business. After one became disqualified by insolvency, the other four took proceedings by which they attempted to enforce a forfeiture against some of their stockholders.

Sir George Jessel, master of the rolls, held that the shareholders were entitled to have the business of the company conducted according to the articles of the association in relation to that proceeding. As between stockholders and the company, that was the correct rule.

In *In re Country Life Assurance Company*, L.R. 5 Ch. App. Cas. 288, a policy signed by three *de facto* directors of the company was enforced in favor of the party insured.

Lord Justice Giffard observed, in delivering his judgment, that he did not hesitate to say that the business of companies could not be carried on if this was not held to be the law.

As to the public, Bell was clearly a director *de facto*, and the corporation was represented in the affair before us by three directors, as required by the statute.

This court has adjudged that, as in favor of creditors and third persons dealing with a corporation in good faith, the regularity and validity of its organization, effected under color of its charter, cannot be impeached, and the acts of its officers, who are officers *de facto* under color of an election, are binding on the corporation. *Hackensack Water Co.* v. *De Kay*, 9 Stew. Eq. 548.

A majority of the directors of a corporation, in the absence of any statutory regulation, is a quorum, and such majority, when convened, can do any act within the power of directors. *Wells* v. *Rahway Rubber Co.*, 4 C. E. Gr. 402.

Under these cases, the fact that no notice of the meeting of directors, at which the mortgages were authorized, was given to Bell cannot affect the validity of these securities. That is a subject into which those who are dealing with a corporation are not bound to inquire. That duty falls on the company alone when it holds out its officers as its accredited agents. Nothing like an approach to safety could exist in transactions with corporate bodies if such an obligation was laid upon third parties contracting with them. After the most careful inquiry, the question would still be open to controversy.

The assignment by Bell for the benefit of creditors was not constructive notice to the appellants that he had ceased to become a shareholder. Actual notice must be shown, and that was not proven.

Those only are chargeable with constructive notice of the assignment who seek to establish a title to his individual property.

The company is estopped from denying the authority of one who is, *de facto*, a director, and in that capacity authorized to represent it.

The fact that the mortgage to the bank was executed to secure an antecedent debt does not impair its standing as between the corporation and its creditor. It was taken in good faith, and it was as much the duty of the company to pay the debt as though it had been contracted at the date of the mortgage.

NOTE. — See, *accord*, *Robinson* v. *Blood*, 151 Cal. 504.

For other cases where the corporation was held to be bound by the action of *de facto* officers, in favor of a third person without notice of the irregularity, see *Chandler* v. *Hart*, 161 Cal. 405 (directors elected at a meeting of stockholders not validly called); *Gleason* v. *Insurance Co.*, 73 N.H. 583 (directors elected at a meeting of stockholders the proceedings in which were not regular); *Wright* v. *Lee*, 2 S.D. 596 (directors elected at a meeting of stockholders held without the State); *Hall* v. *Publishing Co.*, 180 Pa. 561 (directors elected at meeting of directors, instead of meeting of stockholders); *Baird* v. *Bank of Washington*, 11 S. & R. (Pa.) 411 (elected by a proper body, but by a less number of that body than the charter authorized); *Bradford* v. *Frankfort R.R. Co.*, 142 Ind. 383 (officers elected under

an unconstitutional act); *Despatch Line* v. *Bellamy Co.*, 12 N.H. 205 (officer elected was ineligible when elected).

Such action may bind the corporation, even though proceedings to oust the *de facto* officers are pending, and in such proceedings they are later ousted. *Zearfoss* v. *Farmers Institute*, 154 Pa. 449; *Mining Co.* v. *Anglo-Californian Bank*, 104 U.S. 192. In the later case, the *de facto* directors took action after a decision had been rendered ousting them (but before the judgment had been filed) and with knowledge of the decision. It did not appear that the outsider in whose favor the action was taken had knowledge of the decision.

It has been held that a corporation may benefit by the action of *de facto* officers. Thus a contract made, by such officers, with an outsider is enforceable by the corporation. *Delaware & Hudson Canal Co.* v. *Pennsylvania Coal Co.*, 21 Pa. 131; *Ohio R.R. Co.* v. *McPherson*, 35 Mo. 13, 27 (subscription to stock). And a conveyance to a corporation, having only a *de facto* board of directors, vests little in the corporation. *Myott* v. *Greer*, 204 Mass. 389, 393. Thus also, where the outsider has contracted with the corporation, and seeks to defend on the ground that certain corporate acts, conditions precedent to a suit by the corporation on the contract, have not been performed, since the persons assuming to perform them were only *de facto* officers. *Charitable Association* v. *Baldwin*, 1 Metc. (Mass.) 359; *Trustees of Vernon* v. *Hills*, 6 Cowen (N.Y.) 23. This principle would cover a suit by a corporation on a subscription to its stock, where the call was made by *de facto* directors; and see, to that effect, *contra* to the dictum in the principal case, *San Joaquin Co.* v. *Beecher*. 101 Cal. 70. Similarly, a *de facto* board may make a valid discharge of an employee. *Ellis* v. *North Carolina Institution*, 68 N.C. 423.

The conveyance of the right of redemption belonging to a corporation, by *de facto* officers, is valid against a purchaser, at foreclosure sale, of the property to be redeemed. *Baggot* v. *Turner*, 21 Wash. 339.

But mere usurpation will not make a person a *de facto* officer. See *Waterman* v. *Chicago R.R. Co.*, 139 Ill. 658; *Franco-Texan Land Co.* v. *Laigle*, 59 Tex. 339.

C. Liability of Directors for Action or Inaction.

SPERING'S APPEAL.

71 Pa. 11. 1872.

The National Safety Insurance and Trust Company became insolvent in the winter of 1860–1861, and losses to a large amount were sustained by its depositors. They made an assignment for the benefit of creditors on the 18th of April, 1861, to Henry L. Benner, and others. Spering, the plaintiff, was afterwards appointed trustee in their place. This bill was brought by the trustee to compel the directors and others, alleged to be connected with them, to make good the losses, on the ground of fraudulent mismanagement.

Sharswood, J. Upon a careful examination of the record and paper-books, which make up nine hundred and sixty-six printed octavo pages, we have come to the following conclusions of fact, which are supported also by the opinion of the Master. First, That no fraudulent conduct is imputable to any one of the defendants, at any period of time during their administration of the trust. No pecuniary advantage, to the amount of a dollar, was ever realized or sought by any one of them. There was no embezzlement or misappropriation of the funds by any officer or agent of the corporation. There is no pretence that the defendants are liable to account upon either of these grounds. . . . Third, Looking at the history of the institution in the light of subsequent events, its direction was unwise and unfortunate. The money of the depositors was not invested in first-rate and perfectly safe securities, as they engaged to do, and as the funds of such a charity unquestionably ought to be. Loans were largely made upon very doubtful collaterals. Their investments in real estate were injudicious. They lost from a failure to insure. They sought to realize large profits at usurious rates of interest. The crash came in 1860, just before the breaking out of the civil war. All doubtful securities fell in the market. Their debtors went to the wall. In the vain attempt to sustain their credit they sacrificed securities and collaterals. Had they stopped and made an assignment at once, a large amount of the loss which subsequently fell upon them would undoubtedly have been prevented. The story might be much amplified by entering into a detail of particulars: but the conclusion would be the same. Such is a brief résumé of the facts. It is not the history of this institution alone, but of many others in this country.

The broad question then is, whether upon such a state of facts, the directors of a corporation can be made to account for losses arising from mismanagement merely.

It is by no means a well-settled point what is the precise relation which directors sustain to stockholders. They are undoubtedly said in many authorities to be trustees, but that as I apprehend is only in a general sense, as we term an agent or any bailee intrusted with the care and management of the property of another. It is certain that they are not technical trustees. They can only be regarded as mandatories — persons who have gratuitously undertaken to perform certain duties, and who are therefore bound to apply ordinary skill and diligence, but no more. Indeed, as the directors are themselves stockholders, interested as well as all others that the affairs and business of the corporation should be successful, when we ascertain and determine that they have not sought to make any profit not common to all the stockholders, we raise a strong presumption that they have brought to the administration their best judgment and skill. Ought they to be held responsible for mistakes of judgment or want of skill and knowledge? They have been requested by their co-stockholders to take their positions, and they have given their services without compensation. We are dealing now with their responsibility to stockholders, not to outside parties — creditors and depositors.[1] It is unnecessary to consider what the rule may be as to them. Upon a close examination of all the reported cases, although there are many *dicta* not easily reconcilable, yet I have found no judgment or decree which has held directors to account, except when they have themselves been personally guilty of some fraud on the corporation, or have known and connived at some fraud in others, or where such fraud might have been prevented had they given ordinary attention to their duties. I do not mean to say by any means that their responsibility is limited to these cases, and that there might not exist such a case of negligence or of acts clearly *ultra vires*, as would make perfectly honest directors personally liable. But it is evident that gentlemen elected by the stockholders from their own body ought not to be judged by the same strict standard as the agent or trustee of a private estate. Were such a rule applied, no gentlemen of character and responsibility would be found willing to accept such places. The authorities I think fully endorse these views.

[After an examination of the authorities.] These citations, which might be multiplied, establish, as it seems to me, that while directors are personally responsible to the stockholders for any losses resulting from fraud, embezzlement or wilful misconduct or breach of trust for their own benefit and not for the benefit of the stockholders, for gross inattention and negligence by which such fraud or misconduct has been perpetrated by agents, officers or co-directors, yet they are

[1] But the report of the case states that the corporation became insolvent, that losses to a large amount were sustained by its depositors, that it made an assignment for the benefit of its creditors, that this suit was by the successor to such assignee, and that the prayer of his bill was "for a decree against the defendants, to pay the plaintiff sufficient to make good the liabilities of the company."

not liable for mistakes of judgment, even though they may be so gross as to appear to us absurd and ridiculous, provided they are honest and provided they are fairly within the scope of the powers and discretion confided to the managing body.

NOTE. — In *Overend & Gurney Co.* v. *Gibb*, L.R. 5 H.L. 480, the question was whether a director was liable for using the funds of the company in making a purchase which had proved very unprofitable. The director had not derived any personal benefit from the purchase, and had acted in good faith. Lord HARTHERLY said (p. 486): "The question is then simply reduced to this, — whether or not the directors exceeded the powers entrusted to them, or whether if they did not so exceed their powers they were cognisant of circumstances of such a character, so plain, so manifest, and so simple of appreciation, that no men with any ordinary degree of prudence, acting on their own behalf, would have entered into such a transaction as they entered into? Was there *crassa negligentia* on their part which, though not charged in words, is, it is argued, shown by the facts, so that they should be fixed with the loss of the fund intrusted to their hands for the purpose of making the acquisition of the business; was the acquiring of that subject-matter, through the medium of those funds, with the amount of knowledge which the directors had attained, an instance of *crassa negligentia?*"

In *Yates* v. *National Bank*, 206 U.S. 158, the court was considering the standard of conduct required from a director of a national bank. A director is required to swear "that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such association, and will not knowingly violate, or willingly permit to be violated, any of the provisions of this Title." Mr. Justice WHITE said (p. 178): "Mark the contrast between the general common law duty to 'diligently and honestly administer the affairs of the association' and the distinct emphasis embodied in the promise not to 'knowingly violate, or willingly permit to be violated, any of the provisions of this Title.' In other words, as the statute does not relieve the directors from the common law duty to be honest and diligent, the oath exacted responds to such requirements. But as, on the other hand, the statute imposes certain express duties and makes a knowing violation of such commands the test of civil liability, the oath in this regard also conforms to the requirements of the statute by the promise not to 'knowingly violate, or willingly permit to be violated, any of the provisions of this Title.'"

HUN *v.* CARY.

82 N.Y. 65. 1880.

EARL, J. This action was brought by the receiver of the Central Savings Bank of the city of New York, against the defendants who were trustees of the bank, to recover damages which, it is alleged, they caused the bank by their misconduct as such trustees.

The first question to be considered is the measure of fidelity, care and diligence which such trustees owe to such a bank and its depositors. The relation existing between the corporation and its trustees is mainly that of principal and agent, and the relation between the trustees and the depositors is similar to that of trustee and *cestui que trust.* The trustees are bound to observe the limits placed upon their powers in the charter, and if they transcend such limits and cause damage, they incur liability. If they act fraudulently or do a willful wrong, it is not doubted that they may be held for all the damage they cause to the bank or its depositors. But if they act in good faith within the limits of powers conferred, using proper prudence and diligence, they are not responsible for mere mistakes or errors of judgment. That the trustees of such corporations are bound to use some diligence in the discharge of their duties cannot be disputed. All the authorities hold so. What degree of care and diligence are they bound to exercise? Not the highest degree, not such as a very vigilant or extremely careful person would exercise. If such were required, it would be difficult to find trustees who would incur the responsibility of such trust positions. It would not be proper to answer the question by saying the lowest degree. Few persons would be willing to deposit money in savings banks, or to take stock in corporations, with the understanding that the trustees or directors were bound only to exercise slight care, such as inattentive persons would give to their own business, in the management of the large and important interests committed to their hands. When one deposits money in a savings bank, or takes stock in a corporation, thus divesting himself of the immediate control of his property, he expects, and has the right to expect, that the trustees or directors, who are chosen to take his place in the management and control of his property, will exercise ordinary care and prudence in the trusts committed to them — the same degree of care and prudence that men prompted by self-interest generally exercise in their own affairs. When one voluntarily takes the position of trustee or director of a corporation, good faith, exact justice, and public policy unite in requiring of him such a degree of care and prudence, and it is a gross breach of duty — *crassa negligentia* — not to bestow them.

It is impossible to give the measure of culpable negligence for all cases, as the degree of care required depends upon the subjects to

which it is to be applied. (*First Nat. Bank* v. *Ocean Nat. Bank*, 60 N.Y. 278.) What would be slight neglect in the care of a quantity of iron might be gross neglect in the care of a jewel. What would be slight neglect in the care exercised in the affairs of a turnpike corporation, or even of a manufacturing corporation, might be gross neglect in the care exercised in the management of a savings bank intrusted with the savings of a multitude of poor people, depending for its life upon credit and liable to be wrecked by the breath of suspicion. There is a classification of negligence to be found in the books, not always of practical value and yet sometimes serviceable, into slight negligence, gross negligence, and that degree of negligence intermediate the two, attributed to the absence of ordinary care; and the claim on behalf of these trustees is that they can only be held responsible in this action in consequence of gross negligence, according to this classification. If gross negligence be taken according to its ordinary meaning — as something nearly approaching fraud or bad faith — I cannot yield to this claim; and if there are any authorities upholding the claim, I emphatically dissent from them.

It seems to me that it would be a monstrous proposition to hold that trustees, intrusted with the management of the property, interests and business of other people, who divest themselves of the management and confide in them, are bound to give only slight care to the duties of their trust, and are liable only in case of gross inattention and negligence; and I have found no authority fully upholding such a proposition. It is true that authorities are found which hold that trustees are liable only for *crassa negligentia*, which literally means gross negligence; but that phrase has been defined to mean the absence of ordinary care and diligence adequate to the particular case.

In *Spering's Appeal*, Judge SHARSWOOD said that directors "are not liable for mistakes of judgment, even though they may be so gross as to appear to us absurd and ridiculous, provided they were honest, and provided they are fairly within the scope of the powers and discretion confided to the managing body." As I understand this language, I cannot assent to it as properly defining to any extent the nature of a director's responsibility. Like a mandatary, to whom he has been likened, he is bound not only to exercise proper care and diligence, but ordinary skill and judgment. As he is bound to exercise ordinary skill and judgment, he cannot set up that he did not possess them. When damage is caused by his want of judgment, he cannot excuse himself by alleging his gross ignorance. One who voluntarily takes the position of director, and invites confidence in that relation, undertakes, like a mandatary, with those whom he represents or for whom he acts, that he possesses at least ordinary knowledge and skill, and that he will bring them to bear in the discharge of his duties. (Story on Bailments, § 182.) Such is the rule

applicable to public officers, to professional men and to mechanics, and such is the rule which must be applicable to every person who undertakes to act for another in a situation or employment requiring skill and knowledge; and it matters not that the service is to be rendered gratuitously. These defendants voluntarily took the position of trustees of the bank. They invited depositors to confide to them their savings, and to intrust the safe-keeping and management of them to their skill and prudence. They undertook not only that they would discharge their duties with proper care, but that they would exercise the ordinary skill and judgment requisite for the discharge of their delicate trust.

Enough has now been said to show what measure of diligence, skill and prudence the law exacts from managers and directors of corporations; and we are now prepared to examine the facts of this case, for the purpose of seeing if these trustees fell short of this measure in the matters alleged in the complaint.

[The bank was incorporated in 1867, and did business until 1875, when a receiver was appointed. During this time the deposits averaged about $70,000. From 1867 to 1873 the total expenses, including interest paid to depositors, exceeded the income. In 1873 the trustees of the bank, which had hitherto occupied hired premises, purchased, in behalf of the institution, four lots of land, with a view to erecting a bank building upon one of the lots. The greater part of the purchase price was secured by mortgages on the lots. At the time of purchase the bank became obligated to erect upon the corner lot a five story building. Such a building was thereafter erected at an expense of about $27,000. The other lots were disposed of without loss. The corner lot had cost the bank $29,250 (presumably its fair value), exclusive of the building. It was mortgaged for $30,500. When the receiver was appointed, that lot and building, and other assets which produced less than $1000, constituted the whole property of the bank, and subsequently the lot and building were swept away by a mortgage foreclosure. The present action was brought to recover the damages caused to the bank by the alleged improper investment of its funds, as above stated.]

At the time of the purchase of the lot, the bank was substantially insolvent. If it had gone into liquidation, its assets would have fallen several thousand dollars short of discharging its liabilities, and this state of things was known to the trustees. It had been in existence about six years, doing a losing business. The amount of its deposits, which its managers had not been able to increase, shows that the enterprise was an abortion from the beginning, either because it lacked public confidence, or was not needed in the place where it was located. It had changed its location once without any benefit. It had on hand but about $13,000 in cash, of which $10,000 were taken to make the first payments. The balance of its assets

was mostly in mortgages not readily convertible. One was a mortgage for $40,000, which had been purchased at a large discount, and we may infer that it was not very salable, as the trustees resolved to sell it as early as May, 1873, and in August, 1873, authorized it to be sold at a discount of not more than $2500, and yet it was not sold until 1874. In this condition of things the trustees made the purchase complained of, under an obligation to place on the lot an expensive banking-house. Whether, under the circumstances, the purchase was such as the trustees, in the exercise of ordinary prudence, skill and care, could make; or whether the act of purchase was reckless, rash, extravagant, showing a want of ordinary prudence, skill and care, were questions for the jury. It is not disputed that, under the charter of this bank, as amended in 1868 (chap. 294), it had the power to purchase a lot for a banking-house "requisite for the transaction of its business." That was a power, like every other possessed by the bank, to be exercised with prudence and care. Situated as this moribund institution was, was it a prudent and reasonable thing to do, to invest nearly half of all the trust funds in this expensive lot, with an obligation to take most of the balance to erect thereon an extravagant building? The trustees were urged on by no real necessity. They had hired rooms where they could have remained; or if those rooms were not adequate for their small business, we may assume that others could have been hired. They put forward the claim upon the trial that the rooms they then occupied were not safe. That may have been a good reason for making them more secure, or for getting other rooms, but not for the extravagance in which they indulged. It is inferable, however, that the principal motive which influenced the trustees to make the change of location was to improve the financial condition of the bank by increasing its deposits. Their project was to buy this corner lot and erect thereon an imposing edifice, to inspire confidence, attract attention, and thus draw deposits. It was intended as a sort of advertisement of the bank, a very expensive one indeed. Savings banks are not organized as business enterprises. They have no stockholders, and are not to engage in speculations or money-making in a business sense. They are simply to take the deposits, usually small, which are offered, aggregate them, and keep and invest them safely, paying such interest to the depositors as is thus made, after deducting expenses, and paying the principal upon demand. It is not legitimate for the trustees of such a bank to seek deposits at the expense of present depositors. It is their business to take deposits when offered. It was not proper for these trustees — or at least the jury may have found that it was not — to take the money then on deposit and invest it in a banking-house, merely for the purpose of drawing other deposits. In making this investment, the interests of the depositors, whose money was taken, can scarcely be said to have been consulted.

It matters not that the trustees purchased this lot for no more than a fair value, and that the loss was occasioned by the subsequent general decline in the value of real estate. They had no right to expose their bank to the hazard of such a decline. If the purchase was an improper one when made, it matters not that the loss came from the unavoidable fall in the value of the real estate purchased. The jury may have found that it was grossly careless for the trustees to lock up the funds in their charge in such an investment, where they could not be reached in any emergency which was likely to arise in the affairs of the crippled bank.

We conclude, therefore, that the evidence justified a finding by the jury that this was not a case of mere error or mistake of judgment on the part of the trustees, but that it was a case of improvidence, of reckless, unreasonable extravagance, in which the trustees failed in that measure of reasonable prudence, care and skill which the law requires.

Judgment [on verdict for plaintiff] *affirmed.*

NOTE. — See, *accord*, *Greenfield Savings Bank* v. *Abercrombie*, 211 Mass. 252; *Williams* v. *McKay*, 46 N.J. Eq. 25 ("the duty was to lend the bank's money, not only in the manner indicated and required by the charter, but also prudently; the prudence required being measured by the character and objects of the institution").

There are many cases dealing with the liability of directors for inaction, — cases in which subordinate officers misconducted themselves to the damage of the corporation, and the question was presented whether the directors were responsible for not having prevented this. The fact that the director has gained no personal benefit and that he has acted honestly will not excuse him. All the authorities agree that there is a duty of reasonable supervision. In *Briggs* v. *Spaulding*, 141 U.S. 132, the judges divided, 5 to 4, as to whether, on the facts, certain directors were liable. As to the standard of conduct, Mr. Chief Justice FULLER, speaking for the majority, said (p. 165): "Without reviewing the various decisions on the subject, we hold that directors must exercise ordinary care and prudence in the administration of the affairs of a bank, and that this includes something more than officiating as figure-heads. They are entitled under the law to commit the banking business, as defined, to their duly-authorized officers, but this does not absolve them from the duty of reasonable supervision, nor ought they to be permitted to be shielded from liability because of want of knowledge of wrongdoing, if that ignorance is the result of gross inattention."

Mr. Justice HARLAN, speaking for the minority, said: "As to the degree of diligence and the extent of supervision, to be exercised by directors, there can be no room for doubt under the authorities. It is such diligence and supervision as the situation and the nature of the

business requires. Their duty is to watch over and guard the interests committed to them. In fidelity to their oaths, and to the obligations they assume, they must do all that reasonably prudent and careful men ought to do for the protection of the interests of others entrusted to their charge."

If the act done is, or is not, *ultra vires* of the corporation, according to the facts, it would seem to be plain that the director should be required to use ordinary care and reasonable skill in determining the facts. See *Leeds Co.* v. *Shepherd*, L.R. 36 Ch.D. 787 (declaration of a dividend); *Davenport* v. *Lines*, 77 Conn. 473, 480 (same). But see *Lyman* v. *Bonney*, 118 Mass. 222 (return of capital to stockholders).

HODGES *v.* NEW ENGLAND SCREW CO.

1 R.I. 312. 1850.

THE directors of a corporation caused some of its property to be sold, in part, for stock of another corporation. It was claimed that this act was *ultra vires* of the corporation, and that the directors were liable for the consequences. The directors had acted in good faith and with good business judgment.

GREENE, C.J. In 1845, the Screw Company were desirous of enlarging their business, and obtained an amendment of their charter, under which they erected a rolling-mill, and carried on the business of rolling iron; and, afterwards, finding this unprofitable, went into the business of making railroad iron, and carried on that business until it ceased to be profitable, which was in the latter part of the year 1847. The business was then suspended.

The rolling-mill establishment was then without employment. It had cost $155,000, and was discredited in the market by the unprofitable business which had been carried on there. In erecting the rolling-mill establishment, and in carrying on the business there, the Screw Company had incurred a heavy debt. Under these circumstances, the directors of the Screw Company formed the plan of purchasing the nail machine and patent for making wrought nails, and of forming a new company, who were to become the purchasers of the rolling-mill and works, and patent and nail machine, and to carry on the business of making wrought nails. The Screw Company were to sell their nail machine and patent, and rolling-mill, to the new company at cost, being $182,000, and to receive $82,000 in money, and the balance, being $100,000, in the stock of the new company. The whole capital of the new company was to be $300,000, to be divided into six hundred shares of five hundred dollars each, of which the Screw Company were to take two hundred shares, provided two hundred shares were taken by others, and the company organized in three months.

One great object of the directors, in making this arrangement, was to effect a sale of their rolling-mill upon advantageous terms, and to realize from the sale, in order partially, at least, to relieve themselves from debt.

Another object was the anticipated profits of the new business.

The immediate effect of the arrangement was, that the Screw Company received $82,000 in cash, for their rolling-mill and nail machine and patent, and still retained, as a stockholder in the Iron Company, one-third of the same property, the other subscribers to the Iron Company putting their money against the rolling-mill of the Screw Company, at cost. . . .

In considering the question of the personal responsibility of the directors, therefore, we shall assume that they violated the charter of the Screw Company. The question then will be, was such violation the result of mistake, as to their powers, and if so, did they fall into this mistake from want of proper care, such care as a man of ordinary prudence practices in his own affairs. For, if the mistake be such as with proper care might have been avoided, they ought to be liable. If, on the other hand, the mistake be such as the directors might well make, notwithstanding the exercise of proper care, and if they acted in good faith and for the benefit of the Screw Company, they ought not to be liable.

Let us look at the circumstances, under which the directors subscribed for this stock.

At the time of the transaction, no case, in which this question of authority was decided or considered, had occurred, either in England or this country. The law on the subject cannot be considered as known and settled.

There are large classes of corporations in Rhode Island and the other States, which may and do rightfully invest their capital in the stock of other corporations; such, for instance, as religious and charitable corporations, and corporations for literary and scientific purposes. So insurance companies may rightfully invest their capital in the stock of other corporations, such as banks and railroads, and the like. Nor have we any doubt that the Screw Company might have rightfully taken this stock in the Iron Company, in payment for their rolling-mill, if it had been taken with a view to sell again and not permanently to hold it.

Again, it is to be observed, the directors were not investing the dividends of the Screw Company in the stock of the Iron Company. They had on hand an unsaleable rolling-mill, and they owed a heavy debt for it, and one great object in taking the stock in the Iron Company, was to realize for the rolling-mill and in part pay thereby the debt.

The business, too, of the Iron Company was of a kindred nature with that carried on by the Screw Company; and, so far as the man-

ufacture of rods was concerned, intimately connected with the business of the Screw Company.

It was like the case of a corporation for printing calicoes taking stock in the corporation which manufactured and supplied the print cloths. It deserves, also, to be remarked in this connection, that this question of power never seems to have been raised by the directors or the stockholders in either company, or, by the plaintiff himself, until the present bill was filed. Under these circumstances, and giving proper weight to the answers of the defendants, we feel bound to say, that in subscribing for this stock, they have acted in good faith and with as much care and discretion, as a man of ordinary prudence exercises about his own affairs, and that, if they have fallen into a mistake in regard to their powers, it was an innocent mistake, for which they ought not to be held answerable. We have in Rhode Island a large number of corporations, whose affairs are managed by directors, who are generally large stockholders and act without compensation. If the innocent mistakes of these gentlemen, in cases where the law was unsettled or unknown, is to subject them for damages, great injustice would be done. The law requires of them care and discretion, such as a man of ordinary prudence exercises in his own affairs; and if they practice this, and nevertheless make a mistake, the law does not hold them answerable.

GILBERT *v.* FINCH.

72 N.Y. App. Div. 38. 1902.

McLaughlin, J. The complaint alleges, and the evidence adduced upon the trial establishes, that the Commercial Alliance Insurance Company was incorporated in 1888 under the statutes of the State of New York, and that immediately following its incorporation it commenced, and thereafter continued, to do business until October, 1894, when the plaintiff was appointed receiver in an action brought for that purpose by the Attorney-General of the State; that on and prior to the 3d of May, 1893, the defendants and other persons beyond the jurisdiction of the court were the directors of such company, and as such entered into negotiations with the surviving incorporators (ten in number) of the Maine and New Brunswick Insurance Company, a corporation organized under the laws of the State of Maine, for the purchase and control of the latter company by the former; that such negotiations were finally consummated on the day last mentioned, when one Dunham, the president of the Commercial Alliance Company, acting in pursuance of the direction of the defendants and their associate directors, took from the funds of such company $35,000 and paid the same to the ten surviving

incorporators of the Maine and New Brunswick Company, for "a valuable consideration," as expressed therein, and in connection with such bill of sale, Dunham and three others (all of whom were directors of the Commercial Alliance Company) received a transfer or assignment from such surviving incorporators, at the expressed consideration of $3,500 each, of "all their right, title and interest as corporators, associates or otherwise, in said Maine and New Brunswick Insurance Company;" that simultaneously with the execution and delivery of such papers, under an agreement previously made, all of the officers and directors of the Maine and New Brunswick Company resigned, and their places were filled by some of the defendants or persons acting for or on behalf of the Commercial Alliance Company; that on the 22d of July, 1893, the Maine and New Brunswick Company was judicially declared by the Supreme Judicial Court of Maine to be insolvent, and a receiver was appointed to wind up its affairs and distribute its assets among its creditors; that shortly thereafter, in an action brought by this plaintiff in the United States Circuit Court for the district of Maine, against the ten surviving incorporators of the Maine and New Brunswick Company, to recover the money paid to them, aggregating $35,000, the plaintiff received as a compromise of such action the sum of $25,000, and this action was brought to recover the difference between said sum and the $35,000 paid to them, together with interest thereon.

The real question is, whether the directors of an insurance company can take its property and assets and give them away, in the belief and with the expectation that such gift will ultimately benefit the company by bringing to it new business. That directors have no such power cannot be seriously questioned. The transaction by which $35,000 in money was taken from the Commercial Company and paid to the surviving incorporators of the Maine and New Brunswick Company was not only an *ultra vires* act, but it constituted a waste of the funds of the Commercial Company, and to such an extent that those who acquiesced in it or consented to it were liable to respond not only to the stockholders but to the creditors of the Commercial Company to the extent of the funds used. *Mason* v. *Henry*, 152 N.Y. 529. What was done was not a purchase of property at all or even of the good will of a competing company. The Maine Company had nothing which it could sell; it had no assets, and its good will, so far as value was concerned, was purely mythical, as evidenced by the fact that, within a few days after the consummation of the transaction with the Commercial, it passed into the hands of a receiver on the ground that it was insolvent; and, had it been otherwise, it had no more power to sell its good will than had the Commercial Company the power to buy it. But what was done was not even an attempted purchase of either the assets or good will

of that company. The most charitable view that can be taken of the whole transaction is that the $3,500 paid to each of the surviving incorporators of that company was a gift, because there is no claim made that they had anything to transfer, in return for which they permitted the control of the corporation which they represented to pass into the hands of the persons representing the Commercial Alliance Company. The Maine and New Brunswick Company parted with no property, nor did the Commercial Company receive anything for the money paid. The new officers and directors of the Maine and New Brunswick Company, substituted for those who had resigned, even had there been any property or assets of that company, could not have turned it over to or used it for the benefit of the Commercial Company. The Maine Company, it will be remembered, was a mutual company. Its assets were not represented by stock. Its officers and directors as such had no interest whatever in the company or its assets, except to manage the same for all the members. *Huntington* v. *Savings Bank*, 96 U.S. 388. The defendants, therefore, were not authorized, and they had no right whatever, to use the funds of the Commercial Alliance Company in the manner in which they did, and, upon every principle applicable to the management of the business and affairs of a corporation, they must be held liable to make good the loss which was sustained.

Nor is the fact that they acted in good faith of the slightest importance or any excuse for what they did. It may be conceded, and it is undoubtedly true, that what the defendants did was done in good faith upon the supposition that their acts would ultimately turn out for the best interests of the Commercial Company. It is not difficult to see the object sought to be accomplished by the transaction. It was the destruction of the Maine and New Brunswick Company, upon the supposition that, when destruction had finally taken place, out of its ruins would come disappointed policy-holders, the majority of whom would be glad to surrender policies in that company and take new ones in the Commercial Company, for which the Commercial Company would receive the premiums, which would largely increase both its business and assets. But the directors, as indicated, had no power to use the funds of the Commercial Company for this purpose, and the courts, so far as we have been able to discover, never yet have sanctioned, but, on the contrary, have always condemned, this method of acquiring business. Once judicial sanction is given to it, it is not difficult to see how the funds of an insurance company might be used in a stock speculation, a mining scheme, or lost in many other ways which might be suggested. Good business methods forbid it, and the statutes of the State prohibit it.

NOTE. — Affirmed, 173 N.Y. 455.

If directors do acts in the name of the corporation which are *ultra*

vires of the corporation, and from which damage to the corporation results, and if they could not have honestly and reasonably considered the acts to be *intra vires*, it would seem to be clear that they should be liable. *Hill* v. *Murphy*, 212 Mass. 1; *In re National Funds Assurance Co.*, L.R. 10 Ch.D. 118.

People ex rel. Perkins v. *Moss*, 187 N.Y. 410. Although it is *ultra vires* for an insurance corporation to contribute money to a political party, a director who made such contribution in behalf of the corporation out of his own money and then received reimbursement from the corporation is not guilty of larceny from the corporation.

D. Contracts with the Corporation.

MOBILE IMPROVEMENT CO. *v.* GASS.

142 Ala. 520. 1904.

Gass and three other directors voted to convey certain land belonging to the corporation to Gass, on the performance of certain acts by Gass. The three other directors were less than a quorum. The conveyances were thereafter made, and the corporation sought the cancellation of the deeds. The court granted relief against Gass.

Anderson, J. While the deeds sought to be cancelled purport to have been authorized by a resolution passed at a meeting in Mobile in the year 1891, it is an undisputed fact that they were made under and pursuant to a resolution of a bare quorum of directors, at a meeting held at Flint, Michigan, in the year 1896. The evidence also discloses the fact that, at said meeting, the presence of and the participation therein by the respondent, Gass, was necessary to constitute a quorum and to give it legal vitality, and that the vote of Gass secured the passage of the resolution.

The directors of a corporation are the trustees and managing partners, and the stockholders are the *cestui que trust*, and have a joint interest in all of the property and effects of the corporation. *Robinson* v. *Smith*, 3 Paige, 222, 232; *Cunningham* v. *Pell*, 5 Ib. 607; *Slee* v. *Bloom*, 19 Johns. 479.

"If this is the relation, then the rules of law applicable to purchasers by agents and trustees apply to the purchase in question. There is a manifest impropriety in allowing the same person to act as the agent of the seller and to become himself the buyer. There may be, in all such cases, a conflict between the duty and interest. Acting for the best interests of the corporation, his disinterested and unbiassed convictions of duty might be to advise against a sale of the entire property to one creditor, or against any sale at all. It is in

view of these considerations that 'the wise policy of the law hath put the sting of a disability into the temptation, as a defensive weapon against the strength of the danger which lies in the situation.' Even these principles would not, in my judgment, apply in the case, if there had been a quorum without Buell.

"Now the purchase of property by an agent or trustee, or by any person acting in a fiduciary capacity, is not void *ab origine* and absolutely. It is voidable only. It is made subject to the right of the principal or beneficiary, in a reasonable time, to say that he is not satisfied with it. It is valid in equity as well as law, unless the parties interested repudiate it, or complain of it; and these may set it aside without showing either fraud or injury. *Bank of Old Dominion* v. *Dubuque Railroad Co.*, 8 Iowa, 227; *Davoue* v. *Fanning*, 2 Johns. Ch. 252; *Bostwick* v. *Atkins*, 3 Comst. 53, 60; 1 Parsons, Cont. 75, 76 and case in note; 1 Lead. Cases in Eq. 167; *MacGregor* v. *Gardner*, 14 Iowa, 326, 335.

"As the principal or parties interested may confirm the sale, a *mere stranger* cannot make the objection, that the trustee was the purchaser, or that the sale was irregular. The remedy belongs only 'to persons who had an interest in the property before the sale, and no other person can apply to set aside the sale.'" *Corey* v. *Wadsworth*, 118 Ala. 507, 508; *Hawley* v. *Cramer*, 4 Cow. 717, 744; *Edmondson* v. *Welsh*, 27 Ala. 578; *Foster* v. *Goree*, 5 Id. 428; *Hannah* v. *Carrington*, 18 Ark. 85; *Herbert* v. *Henrick*, 16 Ala. 581; *Greenleaf* v. *Queen*, 1 Pet. 138; 5 Barr. 97; *Wightman* v. *Doe*, 24 Miss. 675.

The directors of a corporation are its agents. Their position implies that confidence is reposed in them. The duties which a director assumes to the corporation and the stockholders thereof, disqualifies him from binding the corporation in a transaction in which he is already interested. *O'Connor Mining & Mfg. Co.* v. *Coosa Furnace Co.*, 88 Ala. 630.

NOTE. — The authorities, *accord*, are very numerous.

The transaction is voidable, not void, and if the property came into the hands of a *bona fide* purchaser the equity of rescission would be cut off. In the principal case the plaintiff did not ask the court to disturb the title of the grantees from Gass of a portion of the property conveyed to him. See also *Aberdeen Ry. Co.* v. *Blaikie*, 1 Macq. H.L. 461, 476.

On the sale by a corporation of property held by it in trust to a person acting in behalf of a director, see *Purchase* v. *Atlantic Safe Deposit Co.*, 81 N.J. Eq. 344, aff'd, 91 A. 1070.

MUNSON *v.* SYRACUSE R.R. CO.

103 N.Y. 58. 1886.

A CONTRACT was made between Munson and his associates with the defendant, by the terms of which they were to transfer certain property to the defendant and the defendant was to issue to them certain of its bonds. They sought specific performance of the contract.

ANDREWS, J. . . . We are of opinion that the contract of September 14, 1875, is repugnant to the great rule of law which invalidates all contracts made by a trustee or fiduciary, in which he is personally interested, at the election of the party he represents. There is no controversy as to the facts bringing the case as to Munson within the operation of the rule. He and his associates were dealing with a corporation in which Munson was a director, in a matter where the interests of the contracting parties were or might be in conflict. The contract bound the corporation to purchase, and Munson, as one of the directors, participated in the action of the corporation in assuming the obligation, and in binding itself to pay the price primarily agreed upon between the plaintiffs and Magee. He stood in the attitude of selling as owner and purchasing as trustee. The law permits no one to act in such inconsistent relations. It does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed, and sets aside the transaction or refuses to enforce it, at the instance of the party whom the fiduciary undertook to represent, without undertaking to deal with the question of abstract justice in the particular case. It prevents frauds by making them as far as may be impossible, knowing that real motives often elude the most searching inquiry, and it leaves neither to judge nor jury the right to determine upon a consideration of its advantages or disadvantages, whether a contract made under such circumstances shall stand or fall. It can make no difference in the application of the rule in this case, that Munson's associates were not themselves disabled from contracting with the corporation, or that Munson was only one of ten directors who voted in favor of the contract. The contract on its face, notified Munson's associates of his relation to the corporation, and that the contract was subject to be defeated on that ground, and on the other hand a corporation in order to defeat a contract entered into by directors, in which one or more of them had a private interest, is not bound to show that the influence of the director or directors having the private interest, determined the action of the board. The law cannot accurately measure the influence of a trustee with his associates, nor will it enter into the inquiry, in an action by the trustee in his private capacity, to enforce the contract in the making of which

he participated. The value of the rule of equity, to which we have adverted, lies to a great extent in its stubbornness and inflexibility. Its rigidity gives it one of its chief uses as a preventive or discouraging influence, because it weakens the temptation to dishonesty or unfair dealing on the part of trustees, by vitiating, without attempt at discrimination, all transactions in which they assume the dual character of principal and representative.

NOTE. — Cf. *Porter* v. *Lassen*, 127 Cal. 261; *Clark* v. *American Coal Co.*, 86 Iowa, 436, 449.

FORT PAYNE ROLLING MILL *v.* HILL.

174 Mass. 224. 1899.

HOLMES, C.J. This is an action to recover a sum received or retained by the defendant by way of discount upon debts of the plaintiff company which the defendant settled. This discount was or might have been found to have been received by the defendant in pursuance of votes of the directors by which he was employed to settle claims against the plaintiff company, and was to be allowed five per cent of the face value of bonds used in payment and whatever discount he could get from the claims. He was a director, but took no part in the votes. The main question is, whether after the services have been rendered a receiver of the company has the right as matter of law to avoid the contract under which they were rendered. The jury have found that all parties acted in good faith and that the contract was not improvident. They may have found more specifically that the defendant advanced his own money to settle the claims, that the claims were secured by liens and were being pressed, and that the company had no other way of raising money. We are not prepared to say that the receiver may avoid the contract now. If made with any one else, it would have been binding. It was not illegal or void because made with a director, the only person likely to be willing to make it. In this country it very generally has been deemed impracticable to adopt a rule which absolutely prohibits such contracts. *Nye* v. *Storer*, 168 Mass. 53, 55. Whatever small conflict of interest between himself and the company there may have been, was no greater or other than that between a broker paid by a percentage and his principal. It was manifest and must have been understood. The contract called for action outside the defendant's duty as director, or at least, on the defendant's evidence, needed such action before it could have any effect, for it was no part of the defendant's duty as director to advance his own money. Assuming the contract to have been a provident one, as it well may have been, and as the jury have

found that it was, it seems to us not much more open to objection than a contract with a managing director to pay him a salary.

NOTE. — Where the interested director took no part in the corporate proceedings, the weight of authority in the United States is that the contract is not void, if otherwise unobjectionable. (The burden of proving that the transaction was fair should, it is submitted, be upon the director. See *Cumberland Co.* v. *Parish*, 42 Md. 598.)

But see, *contra*, *Stewart* v. *Lehigh Valley Co.*, 38 N.J.L. 505, in which the court said (p. 523): "Nor is it proper for one of a board of directors to support his contract with his company, upon the ground that he abstained from participating as director in the negotiations for and final adoption of the bargains by his co-directors; the very words in which he asserts his right declare his wrong; he ought to have participated, and in the interest of the stockholders, and if he did not, and they have thereby suffered loss, of which they shall be the judges, he must restore the rights he has obtained — he must hold against them no advantage that he has got through neglect of his duty towards them."

UNITED STATES STEEL CORPORATION v. HODGE.

64 N.J. Eq. 807. 1902.

THE directors of the United States Steel Corporation voted to retire $200,000,000, par value, preferred stock, by issuing to the holders in exchange for such stock its bonds or cash raised by a sale of its bonds. J. P. Morgan was a director of the corporation, and a member of the firm of J. P. Morgan & Co. The corporation, acting by its directors, entered into a contract with J. P. Morgan & Co., which provided that the firm was to purchase a certain number of the bonds, and to pay for them in preferred stock or cash, in consideration of certain commissions. This contract was expressly made subject to the approval of the stockholders. J. P. Morgan & Co. formed a syndicate to insure their performance of the contract. A special meeting of the stockholders was called, the notice stating that some directors were interested in the syndicate. The stockholders approved the contract. The court held that under these facts the contract bound the corporation.

VAN SYCKEL, J. The object of the rule is to prevent directors from secretly using their fiduciary position for their own emolument, and not to impair the right of stockholders to enter into any lawful engagement with a full disclosure of the facts.

In *Stewart* v. *Lehigh Valley Railroad Co.*, *supra*, Mr. Justice DIXON, in delivering the opinion of this court, says: "After an examination

of all the cases cited, as also such others as I have found, and a careful consideration of the principle, and the results of regarding and disregarding it, I have come to the conviction that the true legal rule is that such a contract is not void, but voidable, to be avoided at the option of the *cestui que trust*, exercised within a reasonable time; I can see no further safe modification or relaxation of the principle than this."

It is a settled rule of corporation law that the personal interest of directors renders a transaction voidable at the option of the stockholders, and not void *per se.*

Under the declaration of this court in the case last cited the shareholders may, within a reasonable time after the disclosure to them of the interest of a director, elect to avoid the contract; but if an unreasonable time is allowed to elapse without exercising such option, during which the position of directors become so changed that it would be inequitable to vacate the engagement, equity would refuse to interpose.

A fortiori, when the contract is entered into by the stockholders with the directors, or when the stockholders expressly authorize the directors to enter into a contract, when the stockholders have notice of the directors' interest, the agreement will be unassailable in the absence of actual fraud or want of power in the corporation.

In the case *sub judice*, the contract was in effect made between the stockholders themselves and J. P. Morgan & Co., and it cannot be successfully assailed without maintaining that stockholders are without capacity to make a valid contract with the directors of their company.

It would be manifestly contrary to fair dealing and good faith to permit stockholders to invite directors to enter into an engagement, and after the directors had put themselves in a position in which the contract could be enforced against them, to permit the stockholders to deprive them of the benefits of it.

In my investigation no case has been found which will justify such a result.

NORTHWESTERN TRANSPORTATION CO. *v.* BEATTY

L.R. 12 A.C. 589. 1887.

BILL IN EQUITY by Henry Beatty, a minority stockholder, against the Northwestern Transportation Company, and its directors, including James H. Beatty. The bill seeks to rescind the purchase by the corporation of the steamer *United Empire*.

The material facts are as follows: —

The Transportation Company is a corporation, with a capital stock of $300,000, divided into 600 shares of $500 each. On January 1,

1883, James H. Beatty owned 200 shares, and was a director. He was then building a steamboat, to be called the *United Empire;* and desired to sell it to the company. In January, 1883, he purchased 101 additional shares. On the day of the annual meeting in February, 1883, he transferred 5 shares to Rose and 5 to Laird, whereby they became qualified to be directors; and they were then elected directors. The board was composed of five directors; and James H. Beatty, Rose, and Laird constituted a majority.

The board of directors, while James H. Beatty was present and acting, passed a vote (called a by-law) to purchase the steamboat of James H. Beatty upon specified terms. The directors, at the same time, voted to submit the said by-law to a special meeting of the stockholders. At such meeting, a vote to adopt the by-law was carried by a vote of 306 to 289. Of the 306 affirmative votes, 291 were cast by James H. Beatty, and ten by his transferees, Rose and Laird.

The bill charges that the purchase was not entered into by James H. Beatty *et al.* on behalf of the company in good faith for the purpose of promoting the best interests of the company, but for the purpose of serving their private interests contrary to their duty to the company and its stockholders. Subsequently all charges of fraud and collusion were abandoned. It was proved by uncontradicted evidence, and was substantially admitted, that, at the date of the purchase, the acquisition of another steamer was essential to the efficient conduct of the company's business; that the *United Empire* was well adapted for that purpose; that it was not within the power of the company to acquire any other steamer equally well adapted for its business; and that the price agreed to be paid for the steamer was not excessive or unreasonable.

The case was heard in the Chancery Division, at Toronto, before BOYD, CHANCELLOR, who decreed that the purchase should be set aside. (6 Ontario, 300.)

The Court of Appeal of Ontario (HAGARTY, C.J., BURTON and OSLER, JJ.) unanimously reversed the decree of the Chancellor. (11 Ontario Appeal, 205.)

The Supreme Court of Canada (RITCHIE, C.J., FOURNIER, HENRY, TASCHEREAU, and GWYNNE, JJ.) unanimously reversed the last mentioned decision, and restored the decree of the Chancellor.

SIR W. J. RITCHIE, C.J. Though it may be quite true, as a general proposition, that a shareholder of a company, as such, may vote as he pleases, and for purposes of his own interest, on a question in which he is personally interested, does that proposition necessarily cover this case? Is it not abundantly clear that, whatever a simple stockholder may do, no director is entitled to vote, as a director, in respect to any contract in which he is personally interested? Directors cannot manage the affairs of the company for their own personal and private advantage; they cannot act for themselves and, at the same

time, as the agents of the corporation whose interests are conflicting; they cannot be the sellers of property and the agents of the vendee; there must be no conflict between interest and duty; they cannot occupy a position which conflicts with the interests of the parties they represent and are bound to protect. Is it not somewhat of a mockery to say that this by-law and sale were invalid and bad, and not enforceable against the company as being contrary to the policy of the law by reason of a director entering into the contract for his personal benefit where his personal interests conflicted with the interests of those he was bound to protect, but that it can be set right by a meeting of the shareholders, by a resolution carried by the vote of the director himself against a large majority of the other shareholders? If this can be done, how has the conflict between self-interest and integrity ceased?

While recognizing the general principle of non-interference with the powers of the company to manage its own affairs, this case seems to me to be peculiarly exceptional; a director, acting for the company, makes a sale, acting for himself, to the company, a transaction admittedly indefensible; this purchase is submitted to the shareholders, and the director, having acquired a controlling number of votes for this purpose, secures a majority by his own votes thus obtained without which the purchase would not have been sustained, and confirms as a shareholder his invalid act as a director, and thus validates a transaction against which the policy of the law utterly sets its face.

It does seem to me that fair play and common sense alike dictate that if the transaction and act of the director are to be confirmed, it should be by the impartial, independent, and intelligent judgment of the disinterested shareholders, and not by the interested director himself, who should never have departed from his duty. If he had done his duty and refrained from acting in the transaction as a director the by-law might never have been passed, and the contract of sale never entered into; and having acted contrary to his duty to his co-shareholders he disqualified himself from taking part in the proceedings to confirm his own illegal act; and then to say that he was a legitimate party to confirm his own illegal act seems to me simply absurd, for nobody could doubt what the result in such a case would be, as the futileness of the interested, but discontented, shareholders attempting to frustrate the designs of the interested director with his majority is too manifest; but he, if he had done his duty towards them and refrained from entering into the transaction, would never have been in the position of going through this farce of submitting this matter to the shareholders, and when so submitted of himself voting that he, though he had acted entirely illegally, had done right, and thereby binding all the other shareholders who thought the purchase undesirable; or in other words, by his vote carrying a reso-

lution that the bargain he himself had made for the company as buyer, from himself as seller, was a desirable operation and should be confirmed. . . .

I rest this case entirely on the position Beatty held as a director, and the duty which pertained to that office. In that view it is not necessary to discuss how far, or rather under what circumstances a shareholder may vote at a general meeting of shareholders on matters on which he is individually interested. I cannot, however, but look upon it as rather a bold and startling proposition that a shareholder should be able to offer a property for sale to the company from a bare majority of votes and by such vote, against the will of all the other shareholders, compel the company to become the purchaser at his own price and on his own terms, against the wish of all the other shareholders, who may, as in this case, be a minority of 289 votes against 306.

The case was then carried by appeal to the Judicial Committee of the Privy Council.

Sir Richard Baggallay. . . . The question involved is doubtless novel in its circumstances, and the decision important in its consequences; it would be very undesirable even to appear to relax the rules relating to dealings between trustees and their beneficiaries; on the other hand, great confusion would be introduced into the affairs of joint-stock companies if the circumstances of shareholders, voting in that character at general meetings, were to be examined, and their votes practically nullified, if they also stood in some fiduciary relation to the company.

It is clear upon the authorities that the contract entered into by the directors on the 10th of February could not have been enforced against the company at the instance of the defendant J. H. Beatty, but it is equally clear that it was within the competency of the shareholders at the meeting of the 16th to adopt or reject it. In form and in terms they adopted it by a majority of votes, and the vote of the majority must prevail, unless the adoption was brought about by unfair or improper means.

The only unfairness or impropriety which, consistently with the admitted and established facts, could be suggested, arises out of the fact that the defendant J. H. Beatty possessed a voting power as a shareholder which enabled him, and those who thought with him, to adopt the by-law, and thereby either to ratify and adopt a voidable contract, into which he, as a director, and his co-directors had entered, or to make a similar contract, which latter seems to have been what was intended to be done by the resolution passed on the 7th of February.

It may be quite right that, in such a case, the opposing minority should be able, in a suit like this, to challenge the transaction, and to shew that it is an improper one, and to be freed from the objection

that a suit with such an object can only be maintained by the company itself.

But the constitution of the company enabled the defendant J. H. Beatty to acquire this voting power; there was no limit upon the number of shares which a shareholder might hold, and for every share so held he was entitled to a vote; the charter itself recognised the defendant as a holder of 200 shares, one-third of the aggregate number; he had a perfect right to acquire further shares, and to exercise his voting power in such a manner as to secure the election of directors whose views upon policy agreed with his own, and to support those views at any shareholders' meeting; the acquisition of the *United Empire* was a pure question of policy, as to which it might be expected that there would be differences of opinion, and upon which the voice of the majority ought to prevail: to reject the votes of the defendant upon the question of the adoption of the by-law would be to give effect to the views of the minority, and to disregard those of the majority.

The judges of the Supreme Court appear to have regarded the exercise by the defendant J. H. Beatty of his voting power as of so oppressive a character as to invalidate the adoption of the by-law; their Lordships are unable to adopt this view; in their opinion the defendant was acting within his rights in voting as he did, though they agree with the Chief Justice in the views expressed by him in the Court of Appeal, that the matter might have been conducted in a manner less likely to give rise to objection.

Their Lordships will humbly advise Her Majesty to allow the appeal; to discharge the order of the Supreme Court of Canada; and to dismiss the appeal to that Court with costs; the respondent must bear the costs of the present appeal.

NOTE. — See, *accord*, *Bjorngaard* v. *Goodhue Bank*, 49 Minn. 483; *United States Steel Corporation* v. *Hodge*, 64 N.J. Eq. 807, 813; *Gamble* v. *Water Co.*, 123 N.Y. 91; *Russell* v. *Patterson Co.*, 232 Pa. 113. See also *Middleton* v. *Arastraville Mining Co.*, 146 Cal. 219. Cf. *Klein* v. *Brewing Ass'n*, 231 Ill. 594.

O'CONNER MINING CO. *v.* COOSA FURNACE CO.

95 Ala. 614. 1891.

ONE question presented was as to the validity of certain transfers of property by the Coosa Furnace Co.

WALKER, J. . . . It thus plainly appears that the transactions were between the Coosa Furnace Company and some of its own stockholders and directors, and also two other corporations having

boards of directors composed of the same persons who managed and controlled the first named company.

The directors of a business corporation are its agents. Though they may not be trustees in the technical sense, yet they exercise functions of a fiduciary character. Their position implies that confidence is reposed in them. The duties which a director assumes to the corporation and to the stockholders thereof disqualifies him from binding the corporation in a transaction in which he is adversely interested. He cannot at the same time act for himself and for his principal, without the full knowledge and free consent of the principal. In Morawetz on Private Corporations, § 528, it is said: "A person who is agent for two parties cannot, in the absence of express authority from each, represent them both in a transaction in which they have contrary interests. This rule is based upon the same reason as the rule which prohibits an agent from representing his principal, when his personal interests are opposed to his duty. The principal stipulates for the judgment and skill of his agent, and the latter has no authority to act, when he is not in a position to give the principal the benefits of his best endeavors. It follows, therefore, that the directors, or other agents of a corporation, have no implied authority to bind the company by making a contract with another corporation which they also represent." If the same persons as directors of two different companies represent both companies in a transaction in which their interests are opposed, such transaction may be avoided by either company, or at the instance of a stockholder in either company, without regard to the question of advantage or detriment to either company. Both the corporations are armed with the right to repudiate such a transaction, no matter how fair and open it may be shown to be. *Memphis & Charleston R. Co.* v. *Woods*, 88 Ala. 630, 641.

But the duty which disqualifies the directors from binding the corporation by a transaction in which they have an adverse interest, is one owing to the corporation which they represent, and to the stockholders thereof. A principal may consent to be bound by a contract made for him by an agent who, at the same time, represented an interest adverse to that of the principal. A *cestui que trust* may elect to confirm a transaction which he could have repudiated on the ground that the trustee had an interest in the matter not consistent with his trust relation. In like manner, dealings between corporations, represented by the same persons as directors, may be accepted as binding by each corporation and the stockholders thereof. The general rule is, that such dealings are not absolutely void, but are voidable at the election of the respective corporations, or of the stockholders thereof. They become binding, if acquiesced in by the corporations and their stockholders.

NOTE. — Where a contract is made between corporations having common directors, either corporation may avoid the contract, if it was not represented by a quorum, excluding the common directors. See, in *accord* with the doctrine of the principal case, *San Diego* v. *San Diego R.R. Co.*, 44 Cal. 106; *Pittsburgh Ry. Co.* v. *Dodd*, 115 Ky. 176; *McLeod* v. *Lincoln Medical College*, 69 Neb. 550, 555; *Pearson* v. *Concord R.R. Corp.*, 62 N.H. 537; *Metropolitan Telephone Co.* v. *Domestic Telegraph Co.*, 44 N.J. Eq. 568; *Continental Ins. Co.* v. *New York & Harlem R.R. Co.*, 187 N.Y. 225, 238. As to ratification, see *San Diego R.R. Co.* v. *Pacific Beach Co.*, 112 Cal. 53.

Cf. *Evansville Co.* v. *Bank of Commerce*, 144 Ind. 34 (note not invalid where it represented a just debt); *Bank* v. *Prescott*, 60 Kan. 490.

But it may not be avoided if it was represented by a quorum, excluding the common directors. *Booth* v. *Robinson*, 55 Md. 419, 441; *Rolling Co.* v. *Railroad*, 34 Ohio, 450. Whether this is law in all jurisdictions, *quære*.

On the effect of a director of one corporation being a stockholder in another corporation cf. *Transvaal Lands Co.* v. *New Belgium Co.*, [1914] 2 Ch. 488, with *Pierce* v. *Old Dominion Copper Co.*, 67 N.J. Eq. 399.

E. Purchases of Corporate Property or Obligations.

JANNEY *v.* MINNEAPOLIS INDUSTRIAL EXPOSITION.

79 Minn. 488. 1900.

START, C.J. The defendant the Minneapolis Industrial Exposition is and has been a corporation since November 5, 1885. The management of its affairs was vested in a board of twenty-five directors. The plaintiffs Janney and Nelson have been such directors since the organization of the corporation to the present time; the plaintiff Swift has been such director since 1890; and the plaintiff Donaldson was such director from 1890 until the time of his death, in 1899. Several of the appellants were also directors of the corporation at the time of the sale of its property here in question. The corporation became hopelessly insolvent, and on June 20, 1895, duly made to the Minneapolis Trust Company, pursuant to the insolvency laws of the State, an assignment for the benefit of its creditors.

Such assignee was first, by order of court, directed to advertise for bids for the property, or any part or portion thereof, so assigned to it. But after due advertisement and effort it was unable to effect any sale thereof, except as to two certain lots of land which it was by order of the court directed to convey. As to the main part of the property so assigned, it was unable to and did not receive any bids.

Subsequently, by the order of the court, the assignee was authorized to advertise and sell the remaining assets and property so assigned to it at public vendue to the highest bidder. Accordingly the assignee duly advertised and held such sale, but there were no bidders for the property or any part thereof, except the plaintiff Janney, who then was, either in his own behalf or in behalf of himself and the other plaintiffs herein, a *bona fide* creditor of the corporation to an amount exceeding $54,948.82. The claim of Janney as such creditor, as well as the entire claim of the plaintiffs, amounting in the aggregate to the further sum of $25,905.32, had been, prior to the sale, duly proven in the insolvency proceedings, and had been duly allowed. The plaintiff Janney at such sale, in order to protect his interests and the interests of the plaintiffs, did, in good faith, bid for the property at the sale the sum of $25,100, which sum was the highest and the only sum bid therefor. The assignee duly reported the sale to the court for confirmation and approval, and after a hearing thereon it was duly confirmed by the court, and the assignee ordered to convey and turn over to Janney the property so sold to him, which was done, he paying the assignee in cash the sum of $25,100.

The sale was fairly and lawfully conducted, and the amount realized thereat was the highest sum which the assignee was able to obtain for the property. The property so sold to the plaintiffs was, according to the expert testimony, then worth the sum of $100,000. The answer of the appellants shows that they had notice of the sale and transfer of the property to the plaintiffs, and made no objections thereto, because, as they alleged, the plaintiffs promised that after they acquired the property they would organize a new corporation, and transfer the property to it, so as to liquidate the debts of the defendant corporation. There was, however, no evidence in this case tending to show that any such agreement was ever made by any of the plaintiffs; but Janney, shortly after he so purchased the property, tendered and offered the stockholders of the defendant corporation, by notice duly given to them, that, if they desired and would subscribe for stock in a new corporation to be formed for the purpose of taking the property so purchased by him to an amount necessary to liquidate the indebtedness against the corporation, he would cause the corporation to be organized, and transfer to it the property so purchased by him. Only an insignificant number of the defendant stockholders herein expressed any willingness to subscribe to the stock or to avail themselves of the proposition, and stock in the proposed corporation to the amount of about $12,000 and no more was subscribed.

It was nearly a year after the sale of the property to the plaintiffs that the appellants first objected to the sale, when they did so in their answer herein, and asked that the plaintiffs be charged with, and be required to account for, the difference between the purchase

price paid by the plaintiffs for the property and its value. Their answer also prayed for general relief. The trial court did not find that if a resale of the property was ordered it would bring an increased price, or that there was any reasonable probability that such would be the case, other than may be inferred, if at all, from the value of the property as found by the court. . . .

The appellants further claim that the trial court erred in its conclusions of law, for the reason that the court, upon the facts found, ought to have ordered a resale of the property at an upward bid above the amount paid by the plaintiffs, or applied *pro tanto* upon their debts against the corporation the difference between the amount they paid for the property and its value as found by the court. This conclusion rests upon the assumption that in purchasing the property at the assignee's sale, pursuant to the order of the court, the plaintiffs violated their duties as directors. If the premises are correct, the conclusion would seem to follow that the stockholders are entitled to some relief if not guilty of laches. But are the premises correct? This question must be answered from a consideration of the special facts of this case with reference to the general principles of law applicable to the rights, duties, and disabilities of directors of a corporation.

The relation between a corporation and its directors is that of principal and managing agents. They are not trustees in the sense of holding the legal title to any of its property for its benefit, or that of its stockholders or its creditors. Still, the relation is essentially a fiduciary one, and upon sound principles of public policy directors are inhibited, as a general rule, from purchasing for their own benefit the property of the corporation, very much as a trustee is disqualified from purchasing for his own advantage the property of his *cestui que* trust. This proposition, upon principle and authority, is unquestionably the law. *Beach* v. *Miller*, 130 Ill. 162, 17 Am. St. Rep. 291, 298, notes; 3 Thompson, Corp. § 4071; 2 Cook, Stockh. § 653. It is, however, equally clear upon principle that where the legal title and control of all of the property of a corporation is vested in an assignee or receiver, in trust for the benefit of its creditors, and the court orders the property sold for the purposes of the trust, a director-creditor, having interests to protect, may in good faith purchase the property at such sale, and acquire thereby the absolute title thereto. Especially is this so where there are other active directors, and the sale is made subject to confirmation by the court, and is approved by it. But in all such cases the director must act in the utmost good faith, for the transaction will be jealously scrutinized. 1 Morawetz, Priv. Corp. § 527; 3 Thompson, Corp. §§ 4068, 4074; *Barber* v. *Bowen*, 47 Minn. 118, 49 N.W. 684; *Twin-Lick Oil Co.* v. *Marbury*, 91 U.S. 587; *Appeal of Lusk*, 108 Pa. St. 152.

The facts of this case bring it within the exception to the general

rule that directors cannot purchase the property of the corporation for their own benefit. The title, possession, and control of the property were in the hands of an officer of the court (the assignee), and had been for nearly a year prior to the sale. The sale was made by direction of the court, and subject to its confirmation. The plaintiffs had no control over the property or the assignee, who was the representative of the corporation, its creditors, and its stockholders. They had no power to prevent or control the sale, which was a judicial one, brought about by the court through its officer. They had material interests to protect by bidding at the sale. They purchased in good faith, at the best price obtainable. The appellants had notice of the sale, and did not object thereto until long afterwards. See *Pinkus* v. *Minneapolis Linen Mills*, 65 Minn. 40, 67 N.W. 643. The sale was fairly conducted, and was confirmed by the court. There were twenty-one directors at the time besides the plaintiffs. These facts justify the conclusion of the trial court to the effect that the plaintiffs, in purchasing the property to protect their own interests, did not violate their duties to the corporation. The facts found by the court justify its conclusions of law.

Order affirmed.

NOTE. — *Nowak* v. *National Car Coupler Co.*, 260 Ill. 260. A director of a solvent corporation which is about to wind up its affairs because its charter has expired is not disabled from purchasing the property for himself or for a new corporation which has been organized, provided he acts with the utmost fairness, so that the property shall bring its full value.

SEYMOUR *v.* SPRING FOREST CEMETERY ASSOCIATION.

144 N.Y. 333. 1895.

FINCH, J. . . . But the further claim is made that, because Hotchkiss and Seymour were officers of the corporation, holding a fiduciary relation as trustees or directors, they could not lawfully buy the valid and outstanding obligations of the company at less than par and enforce them for the full amount against the debtors. If that be sound doctrine, as is stoutly maintained, if directors cannot in any case invest in the bonds of their own companies except at the peril of a constructive fraud, if they cannot safely buy such bonds below par, because they deem them unduly depressed, if titles to corporate obligations passing through their hands become tainted by their touch, it is quite time that the courts should give, what they have not given, a very definite and distinct warning. Some citations of seeming authority are pressed upon us and others exist. The broad rule is

stated in Perry on Trusts (§ 428), that "a trustee, executor or assignee cannot buy up a debt or incumbrance to which the trust estate is liable for less than is actually due thereon, and make a profit to himself," and that is the doctrine invoked in this case as applicable to a director regarded as a trustee of the corporation. But the statement, however correct in its application to specific instances, must be taken with the limitations which belong to it. Its foundation is that a fiduciary agent, owing a duty to his principal, cannot make a contract for his own benefit which is or may be inconsistent with that duty, and the cases generally are of two kinds. The trustee buys in the property of his principal at a sacrifice for his own benefit, when, if he bought it at all, it was his duty to do it for his principal, or he makes a contract in behalf of his principal with himself directly or indirectly as the other party to the agreement. The first class of cases is illustrated by *Slade* v. *Van Vechten*, 11 Paige, 26, where the assignee bought in assigned property at a sheriff's sale and claimed the personal benefit of his bargain; and the second class by *Munson* v. *S. G. & C. R.R. Co.*, 103 N.Y. 58, in which the directors contracting had a private and personal interest, possibly adverse to their fiduciary duty. Almost, if not quite all, of the cases cited by the learned counsel for the appellant belong to one or the other of these two classes. But they do not decide this case, for Hotchkiss and Seymour neither bought in any property of the company nor dealt with the corporation in any respect. They made their contract, not with it, but with third persons capable of protecting their own rights, and bought nothing which the corporation owned or to which it had a right. We must go to still other cases, founded it may be to some extent upon similar ideas of fiduciary duty, to discover even an approximate authority. There are cases of co-partnership in which the general rules pertaining to that specific relation might prove to be broad enough to cover the purchase of the debt owing by the firm (*Am. Bk. Note Co.* v. *Edson*, 56 Barb. 89), and other cases in which the duties flowing from a liquidation conducted by the trustee, and as to which he owes a specific trust duty, forbid a purchase by the trustee for his own benefit at a discount. But in every class of cases the rule is founded upon the unwillingness of the law to uphold contracts which bring into collision the trust duty and the personal interest, and it is because of that collision, and the temptations which surround it, that it declares the contract voidable at the election of the beneficiary without investigating the good or bad faith of the trustee. The entire basis of the rule consists in this collision between trust duty and personal interest, and the equitable prohibition has no application where there is no such possible inconsistency. There is no such conflict in the ordinary case of the purchase by a director in a going corporation of its outstanding obligations. There is no present duty resting upon him to extinguish them. The time for that has not

come, the duty has not arisen, may never arise, the corporation is not prepared to pay, does not contemplate paying, but intends and expects to await the full maturity of the debt. Unless some special fund has been provided, or some special liquidation has been ordered, the director owes no duty to his company to discharge or buy in the outstanding bonds, and may purchase for himself because no inconsistent trust duty has arisen. Why should he not? While the bonds are running to their maturity, and the corporation is not able to extinguish them, is not bound to do so, does not even wish or seek to do so, what does it matter who holds the securities or on what terms they pass from hand to hand? It seems to me that we are asked to crowd the rule almost to the verge of an absurdity, and to inflict a vital injury upon business interests by tainting with invalidity the holding by a director of the unmatured obligations of the corporation bought by him in the open market and not put in liquidation or sought to be extinguished. There must at least be some fact or circumstance which charges the trustee with a present duty to act for his company in respect to the bonds, which duty is or may be inconsistent with a personal purchase. No such duty rested upon Hotchkiss and Seymour, and they had a right to buy and hold for their own benefit.

Indeed, there is a further and equally conclusive answer. If the doctrine invoked applied to this case it would make the purchase not void but voidable at the election of the corporation, and that election must be made promptly and upon sufficient knowledge of the facts. The beneficiary cannot wait and speculate upon the chances of delay, but must act. Here the purchase was made before 1873, and in 1880 the corporation is found recognizing and ratifying the title of the vendees or their successors, making payments to them, and providing for future payments, and it is only after a delay of fifteen years that an attempt to repudiate the purchase is made.

F. Relation to Stockholders.

CROWELL *v.* JACKSON.

53 N.J.L. 656. 1891.

THE action was for deceit in the purchase of certain shares of the capital stock of the Holbrook Printing Company by the defendant from the plaintiff. The declaration alleges that the plaintiff was a shareholder of the Holbrook Printing Company, and that the defendant was a director and the treasurer of that company; that the company had made a favorable sale of property which enhanced the

value of its stock; that the sale was known only to the directors and officers of the company; that the plaintiff had no knowledge of it and no knowledge of facts which put him on inquiry with reference to it; that the defendant knew of it, and knew that it enhanced the value of the stock, and that the plaintiff was ignorant of it; that, possessing this knowledge, he bought the plaintiff's shares of stock at a price for which the plaintiff, in his ignorance of the advantageous sale by the corporation, was willing to sell them, which was much below the real value of the stock purchased.

The opinion of the court was delivered by

THE CHANCELLOR. We are of opinion that, in contemplation of law, there can be no fraud without moral delinquency; in other words, that there is no actual fraud which is not also moral fraud. In purchase or sale, if there be no designed misrepresentation by words or deeds and no active intentional concealment, and no intentional silence where there is a duty to speak, an action for deceit will not lie. A director, or the treasurer, of a corporation, is not, because of his office, in duty bound to disclose to an individual stockholder, before purchasing his stock, that which he may know as to the real condition of the corporation affecting the value of that stock. He is, to some extent, trustee for the stockholders, as a body, in respect to the property and business of the corporation, but does not sustain that relation to individual stockholders with respect to their several holdings of stock over which he has no control.

NOTE. — In *Hooker* v. *Midland Steel Co.*, 215 Ill. 444, the director opened negotiations. The court said (p. 450): "It is contended that Beatty, being the president and director of the Midland Steel Company, was a trustee for the complainant as a stockholder, and was therefore in a fiduciary and confidential relation requiring him to disclose all such facts within his knowledge, and that he could not retain a benefit acquired by a breach of that duty or use knowledge in his possession to obtain a bargain from the complainant. The management of the business and property of a corporation is entrusted to its officers, and they are empowered to act for the whole body of stockholders. They therefore occupy the position of trustees for the stockholders as a body in respect to such business and property, and cannot have or acquire any personal or pecuniary interest in conflict with their duty as such trustees. A director, however, does not sustain that relation to an individual stockholder with respect to his stock, over which he has no control whatever, but he may deal with an individual stockholder and purchase his stock practically on the same terms as a stranger. In the absence of actual fraud such a purchase will not be set aside for a mere failure to disclose any information the director may have affecting the value of the stock."

Other cases in which a director, purchasing stock from a stockholder, was held not to be under a fiduciary's duty to disclose are *Tippecanoe County* v. *Reynolds*, 44 Ind. 509; *Bawden* v. *Taylor*, 254 Ill. 464; *Walsh* v. *Goulden*, 130 Mich. 531; *Carpenter* v. *Danforth*, 52 Barb. (N.Y.) 581; *Deaderick* v. *Wilson*, 8 Baxter (Tenn.) 108; *Haarstick* v. *Fox*, 9 Utah, 110; *O'Neile* v. *Ternes*, 32 Wash. 528; *Percival* v. *Wright*, [1902] 2 Ch. 421.

STRONG *v.* REPIDE.

213 U.S. 419. 1909.

ACTION brought by the plaintiff, as the owner of eight hundred shares of the capital stock of the *Philippine Sugar Estates Development Company, Limited*, to recover such shares from the defendant. The defendant owned 30,400 of the 42,300 shares issued by the company, was one of the five directors of the company, and had been elected by the board of directors as the agent and administrator general of such company "with exclusive intervention in the management" of its general business.

MR. JUSTICE PECKHAM. In 1902 it was thought important for the Government of the United States to secure title, if reasonably possible, to what were called the friar lands in the Philippine Islands. To that end various inquiries were made on the part of the Government from time to time as to the possibility of obtaining title to all those lands and what would be the probable expense. The lands were not owned by the same people, but were divided among different and separate owners. The Philippine Sugar Estates Development Company, Limited, owned of these lands what are more particularly described as the Dominican lands, and they were regarded as nearly one-half the value of all the friar lands.

On July 5, 1903, the governor of the Philippine Islands, on behalf of the Philippine Government, made an offer of purchase for the total sum of $6,043,219.47 in gold for all the friar lands, though owned by different owners. This offer, so far as concerned that portion of the lands owned by defendant's company, was rejected by defendant in his capacity as majority shareholder, without any consultation with the other shareholders. The representatives of all the different owners of all the lands, including defendant's company, in answer to the above offer, then fixed their selling price at $13,700,000 for all of such lands. During the negotiations consequent upon these different offers, which lasted for some time after the first offer was made, an offer was finally, and towards the end of October, 1903, made by the governor of $7,535,000. All the owners of all these friar lands, with the exception of the defendant who represented his com-

pany, were willing and anxious to accept this offer and to convey the lands to the Government at that price. He alone held out for a better offer while all the other owners were endeavoring to persuade him to accept the offer of the Government. The defendant continued his refusal to accept until the other owners consented to pay to his company $335,000 of the purchase price for their land and until the Government consented that a thousand hectares should be excluded from the sale to it of the land of defendant's company. This being agreed to the contract for the sale was finally signed by the defendant as attorney in fact for his company, December 21, 1903. The defendant, of course, as the negotiations progressed knew that the decision of the question lay with him, and that if he should decide to accept the last offer of the Government his decision would be the decision of his company, as he owned three-fourths of its shares, and the negotiations would then go through as all the owners of the balance of the land desired it. If the sale should not be consummated and things should remain as they were, the defendant also knew that the value of the lands and of the shares in the company would be almost nothing. He himself says, in speaking of these lands owned by his company, that had the Government "given the haciendas the protection which they ought to have received they would have been worth $6,000,000 gold; but, considering the abnormal condition in which they were on account of the failure of the Government to protect these haciendas, it is impossible to fix any value; they were worth nothing; they were a charge." Also, the company had paid no dividends, and only lived on its credit, and could not even pay taxes. The company had no other property of any substantial value than these lands. They were its one valuable asset.

While this state of things existed, and before the final offer had been made by the governor, the defendant, although still holding out for a higher price for the lands, took steps, about the middle or latter part of September, 1903, to purchase the 800 shares of stock in his company owned by Mrs. Strong, which he knew were in the possession of F. Stuart Jones, as her agent. The defendant, having decided to obtain these shares, instead of seeing Jones, who had an office next door, employed one Kauffman, a connection of his by marriage, and Kauffman employed a Mr. Sloan, a broker, who had an office some distance away, to purchase the stock for him, and told Sloan that the stock was for a member of his wife's family. Sloan communicated with the husband of Mrs. Strong and asked if she desired to sell her stock. The husband referred him to Mr. Jones for consultation, who had the stock in his possession. Sloan did not know who wanted to buy the shares, nor did Jones when he was spoken to. Jones would not have sold at the price he did had he known it was the defendant who was purchasing, because, as he said, it would show increased value, as the defendant would not be likely

to purchase more stock unless the price was going up. As the articles of incorporation, by subdivision twenty, required a resolution of the general meeting of stockholders for the purpose of selling more than one hacienda, and as no such general meeting had been called at the time of the sale of the stock, Mr. Jones might well have supposed there was no immediate prospect of a sale of the lands being made, while at the same time defendant had knowledge of the probabilities thereof, which he had acquired by his conduct of the negotiations for their sale, as agent of all the shareholders, and while acting specially for them and himself.

The result of the negotiations was that Jones, on or about October 10, 1903, assuming that he had the power, and without consulting Mrs. Strong, sold the 800 shares of stock for $16,000, Mexican currency, delivering the stock to Kauffman in Sloan's office, who paid for it with the check of Rueda Hermanos for $18,000, the surplus $2,000 being arranged for, and Kauffman being paid $1,800 by defendant for his services. The defendant thus obtained the 800 shares for about one-tenth of the amount they became worth by the sale of the lands between two and three months thereafter. In all the negotiations in regard to the purchase of the stock from Mrs. Strong, through her agent Jones, not one word of the facts affecting the value of this stock was made known to plaintiff's agent by defendant but, on the contrary, perfect silence was kept. The real state of the negotiations with the Government was not mentioned, nor was the fact stated that it rested chiefly with the defendant to complete the sale. The probable value of the shares in the very near future was thus unknown to any one but defendant, while the agent of the plaintiff had no knowledge or suspicion that defendant was the one seeking to purchase the shares. The agent sold because, as he testified, he wanted to invest the money in some kind of property that would pay dividends, and he was expecting nothing from this company, as negotiations for the sale of the lands had gone on so long, and there appeared no prospect of any sale being made, at any rate not for a very long time.

It is undeniable that during all this time the subject of the sale of the friar lands was frequently mooted and its probabilities publicly discussed in a general way. Such discussion was founded upon rumor and gossip as to the condition of the negotiations. The public press referred to it not infrequently, but the actual state of the negotiations, the actual probabilities of the sale being consummated, and the particular position of power and influence which the defendant occupied in such negotiations, prior to the time of the purchase of plaintiff's stock, were not accurately known by plaintiff's agent or by any one else outside those interested in the matter as negotiators.

The question in this case, therefore, is whether, under the circumstances above set forth, it was the duty of the defendant, acting in

good faith, to disclose to the agent of the plaintiff the facts bearing upon or which might affect the value of the stock.

If it were conceded, for the purpose of the argument, that the ordinary relations between directors and shareholders in a business corporation are not of such a fiduciary nature as to make it the duty of a director to disclose to a shareholder the general knowledge which he may possess regarding the value of the shares of the company before he purchases any from a shareholder, yet there are cases where, by reason of the special facts, such duty exists. The supreme courts of Kansas and of Georgia have held the relationship existed in the cases before those courts because of the special facts which took them out of the general rule, and that under those facts the director could not purchase from the shareholder his shares without informing him of the facts which affected their value. *Stewart* v. *Harris*, 69 Kansas, 498; s.c., 77 Pac. Rep. 277; *Oliver* v. *Oliver*, 118 Georgia, 362; s.c., 45 S.E. Rep. 232. The case before us is of the same general character. On the other hand, there is the case of *Board of Commissioners* v. *Reynolds*, 44 Indiana, 509–515, where it was held (after referring to cases) that no relationship of a fiduciary nature exists between a director and a shareholder in a business corporation. Other cases are cited to that effect by counsel for defendant in error. These cases involved only the bare relationship between director and shareholder. It is here sought to make defendant responsible for his actions, not alone and simply in his character as a director, but because, in consideration of all the existing circumstances above detailed, it became the duty of the defendant, acting in good faith, to state the facts before making the purchase. That the defendant was a director of the corporation is but one of the facts upon which the liability is asserted, the existence of all the others in addition making such a combination as rendered it the plain duty of the defendant to speak. He was not only a director, but he owned three-fourths of the shares of its stock, and was, at the time of the purchase of the stock, administrator general of the company, with large powers, and engaged in the negotiations which finally led to the sale of the company's lands (together with all the other friar lands) to the Government at a price which very greatly enhanced the value of the stock. He was the chief negotiator for the sale of all the lands, and was acting substantially as the agent of the shareholders of his company by reason of his ownership of the shares of stock in the corporation and by the acquiescence of all the other shareholders, and the negotiations were for the sale of the whole of the property of the company. By reason of such ownership and agency, and his participation as such owner and agent in the negotiations then going on, no one knew as well as he the exact condition of such negotiations. No one knew as well as he the probability of the sale of the lands to the Government. No one knew as

well as he the probable price that might be obtained on such sale. The lands were the only valuable asset owned by the company. Under these circumstances and before the negotiations for the sale were completed the defendant employs an agent to purchase the stock, and conceals from the plaintiff's agent his own identity and his knowledge of the state of the negotiations and their probable result, with which he was familiar as the agent of the shareholders and much of which knowledge he obtained while acting as such agent and by reason thereof. The inference is inevitable that at this time he had concluded to press the negotiations for a sale of the lands to a successful conclusion, else why would he desire to purchase more shares which, if no sale went through, were, in his opinion, worthless, because of the failure of the Government to properly protect the lands in the hands of their then owners? The agent of the plaintiff was ignorant in regard to the state of the negotiations for the sale of the land, which negotiations and their probable result were a most material fact affecting the value of the shares of stock of the company, and he would not have sold them at the price he did had he known the actual state of the negotiations as to the lands and that it was the defendant who was seeking to purchase the stock. Concealing his identity when procuring the purchase of the stock, by his agent, was in itself strong evidence of fraud on the part of the defendant. Why did he not ask Jones, who occupied an adjoining office, if he would sell? But by concealing his identity he could by such means the more easily avoid any questions relative to the negotiations for the sale of the lands and their probable result, and could also avoid any actual misrepresentations on that subject, which he evidently thought were necessary in his case to constitute a fraud. He kept up the concealment as long as he could, by giving the check of a third person for the purchase money. Evidence that he did so was objected to on the ground that it could not possibly even tend to prove that the prior consent to sell had been procured by the subsequent check given in payment. That was not its purpose. Of course, the giving of the check could not have induced the prior consent, but it was proper evidence as tending to show that the concealment of identity was not a mere inadvertent omission, an omission without any fraudulent or deceitful intent, but was a studied and intentional omission to be characterized as part of the deceitful machinations to obtain the purchase without giving any information whatever as to the state and probable result of the negotiations, to the vendor of the stock, and to in that way obtain the same at a lower price. After the purchase of the stock he continued his negotiations for the sale of the lands, and finally, he says, as administrator general of the company, under the special authority of the shareholders, and as attorney in fact he entered into the contract of sale December 21, 1903. The whole transaction gives con-

clusive evidence of the overwhelming influence defendant had in the course of the negotiations as owner of a majority of the stock and as agent for the other owners, and it is clear that the final consummation was in his hands at all times. If under all these facts he purchased the stock from the plaintiff, the law would indeed be impotent if the sale could not be set aside or the defendant cast in damages for his fraud.

The Supreme Court of the islands, in holding that there was no fraud in the purchase, said that the responsibility of the directors of a corporation to the individual stockholders did not extend beyond the corporate property actually under the control of the directors; that they did not owe any duty to the members in respect to their individual stock, which would prevent them from purchasing the same in the usual manner. While this may in general be true, we think it is not an accurate statement of the case, regard being had to the facts above mentioned.

It is said that by the code of commerce of the Philippine Islands the directors are declared to be mandatories of the society, and that by article 1459 of the Spanish Civil Code they are prohibited from acquiring by purchase, even at public or judicial auction, the property the administration or sale of which may have been entrusted to them, and that this is the extent of the prohibition. This provision has no reference to the purchase for himself, under such facts as existed here, by an officer of a corporation, of stock in the corporation owned by another. The case before us seems a plain one for holding that, under the circumstances detailed, there was a legal obligation on the part of the defendant to make these disclosures.

NOTE. — Other cases in which a director, purchasing stock from a stockholder, was held to be under a fiduciary's duty to disclose are *Oliver* v. *Oliver*, 118 Ga. 362; *Stewart* v. *Harris*, 69 Kan. 498; *Commonwealth Trust Co.* v. *Seltzer*, 227 Pa. 410 (but note the remarks of the court on p. 418); *Fisher* v. *Budlong*, 10 R.I. 525.

Von An v. *Magenheimer*, 126 N.Y. App. Div. 257 (aff'd, 196 N.Y. 510). Directors may not abuse their power by actually or apparently depressing the value of stock for the purpose of acquiring it from a stockholder at an undervaluation.

SMITH *v.* HURD.

12 Met. (Mass.) 371. 1847.

THIS was a special action on the case, by a stockholder of the Phœnix Bank against the directors. There were two counts; one founded in non-feasance of official duty, the other in misfeasance.

The first count alleged (*inter alia*) that it was the duty of the directors to direct and superintend the proceedings of the officers, and to exercise reasonable vigilance in seeing that the property of the bank was not lost, wasted, or misused; but that the directors disregarding their duty, and contriving together to injure and deceive the plaintiff therein, neglected to give reasonable personal attention to the business of the bank; and negligently permitted the whole business to be managed by the president, Wyman, who loaned its monies on insufficient securities, used certain sums himself, and made loans to individual directors exceeding the limits of the law; whereby the bank capital became wholly lost, and plaintiff was made liable, under the law, for his proportion of the capital lost by the official mismanagement of the directors, and further liable to pay large sums for the redemption of the bills of the bank.

The second count alleged (*inter alia*) that the directors, disregarding their duties, and contriving together to injure and deceive the plaintiff therein, concurred with each other that the whole business should be managed by the president, Wyman, as he should see fit; and that defendants themselves declared dividends when there were no profits, and caused false returns to be made to the state authorities, by which means plaintiff was misled and induced to rely on the security of his investment. And, generally, the second count charged as acts of the defendants (done through Wyman) the matters which, in the first count, were charged as negligences and permissions, and deduced therefrom in like manner the failure of the bank, and the special damage to the plaintiff. The count concluded with an averment that defendants, by "misconducting the business of said bank, as aforesaid, so wilfully, deceitfully and fraudulently mismanaged the business and property of the said bank, that the whole capital thereof was utterly lost and wasted."

Defendants demurred to the declaration.

SHAW, C.J. This is certainly a case of first impression. We are not aware that any similar action has been sustained in England, or in any of the courts of this country. It is founded on no statute. It is an action on the case, at common law, brought by an individual holder of shares in an incorporated bank, against the directors, not including the president, setting forth various acts of negligence and malfeasance, through a series of years, in consequence of which, as the declaration alleges, the whole capital of the bank was wasted and lost, and the shares of the plaintiff became of no value. The circumstance that no such action has been maintained, would certainly be no decisive objection, if it could be shown to be maintainable on principle. But the fact, that similar grievances have existed to a great extent, and in numberless instances, where such an action would have presented an obvious and effective remedy, affords strong proof, that in the view of all such suffering parties, and their

legal advisers and guides, there was no principle on which such an action can be maintained.

If an action can be brought by one stockholder, it may be brought by the holder of a single share; so that for one and the same default of these directors, thirty-five hundred actions might be brought. If it may be sustained by proof of an act, or series of acts, of carelessness, neglect, and breach of duty, in managing the affairs of the bank, by which the whole value of the stock is destroyed, it may, on the same principle, be maintained on any act or instance of such negligence, by which the shares are diminished in value fifty, ten, five, or one per cent. Still, notwithstanding these consequences, if the plaintiff has a good right of action, upon recognized and sound legal principles, his action ought to be sustained.

But the court are of opinion that the action cannot be maintained; and that on several grounds, a few of the more prominent of which may be alluded to.

1. There is no legal privity, relation, or immediate connexion, between the holders of shares in a bank, in their individual capacity, on the one side, and the directors of the bank on the other. The directors are not the bailees, the factors, agents or trustees of such individual stockholders. The bank is a corporation and body politic, having a separate existence as a distinct person in law, in whom the whole stock and property of the bank are vested, and to whom all agents, debtors, officers and servants are responsible for all contracts, express or implied, made in reference to such capital, and for all torts and injuries diminishing or impairing it. The very purpose of incorporation is, to create such legal and ideal person in law, distinct from all the persons composing it, in order to avoid the extreme difficulty, and perhaps it is not too much to say the utter impracticability, of such a number of persons acting together in their individual capacities. The practical difficulty would be nearly as great, whether it were held that all must join in an action to recover damage for an injury to the common property, or that each might sue separately.

The stockholders do, indeed, ordinarily elect the directors; but it is as parts and members of the corporation, in their corporate capacity, in modes pointed out by the charter and by-laws, so that the directors are the appointees of the corporation, not of the individuals. Indeed, I believe there is a provision in the bank charters — there certainly was formerly — which is equally to the present purpose; namely, that the Commonwealth shall be at liberty to add a certain amount to the capital of various banks, and appoint a proportional number of directors. Such directors, so appointed, pursuant to the charter regulating the legal organization of the body, would stand in all respects on the footing of directors chosen by the stockholders. If these were liable to the action of individual stockholders, those would be, in like manner.

2. The individual members of the corporation, whether they should all join, or each act severally, have no right or power to intermeddle with the property or concerns of the bank, or call any officer, agent or servant to account, or discharge them from any liability. Should all the stockholders join in a power of attorney to any one, he could not take possession of any real or personal estate, any security or chose in action; could not collect a debt, or discharge a claim, or release damage arising from any default; simply because they are not the legal owners of the property, and damage done to such property is not an injury to them. Their rights and their powers are limited and well defined. They are members of an organized body, and exercise such powers as the organization of the institution gives them. Stockholders in banks have a separate right to dividends, when declared, and to a distributive share of the capital stock, if any remains when the charter of the bank is at an end, and its debts paid.

3. But another important consideration is, that the injury done to the capital stock by wasting, impairing, and diminishing its value, is not, in the first instance, nor necessarily, a damage to the stockholders. All sums which could, in any form, be recovered on that ground, would be assets of the corporation, and when collected and received by directors, receivers, or any other persons entitled to receive the same, they would be held in trust, first to redeem the bills and pay the debts of the bank; and it would be only after these debts were paid, and in case any surplus should remain, that the stockholders would be entitled to receive any thing. It is, therefore, an indirect, contingent and subordinate interest, which each stockholder has, in damages so to be recovered against directors. If, upon such indirect, contingent, and remote interest, individual stockholders could recover for the defaults of directors, and especially, as is alleged in this case, where these defaults have been so great as to sink the capital, *a fortiori* would the creditors of the bank individually have a right to maintain similar actions; because their claim upon the funds, being prior to that of stockholders, would be somewhat more immediate and direct.

In the same connexion, it is obvious to remark, that a judgment in favor of one stockholder would be no bar to an action by a creditor, nor a judgment by both, to an action by the corporation.

4. But it is said, that although the real and personal estate, the securities and capital stock, are, in legal contemplation, vested in the corporation, yet the individual has a separate and distinct property and interest in his particular shares, by any injury to which he may have a separate damage. To some extent, it is true that he has a several interest in his shares; but it is to be taken with some qualifications. Strictly speaking, shares in a bank do not constitute a legal estate and property; it is rather a limited and qualified right which the stockholder has to participate, in a certain proportion, in the

benefits of a common fund, vested in a corporation for the common use; it is a qualified and equitable interest, a valuable interest, manifested usually by a certificate, which is transferable. To the extent of this separate and peculiar interest, a stockholder, no doubt, might maintain his separate and special action, according to the nature of the wrong done to him in respect to it; as trover or trespass, for the conversion or tortious taking of his certificate; trespass on the case for refusing to make a transfer on a proper occasion; assumpsit for a dividend declared, and the like. But an injury done to the stock and capital, by negligence, or misfeasance, is not an injury to such separate interest, but to the whole body of stockholders in common. It is like the case of a common nuisance, where one who suffers a special damage, peculiar to himself, and distinguishable in kind from that which he shares in the common injury, may maintain a special action. Otherwise, he cannot. Co. Lit. 56 *a.* 3 Steph. N. P. 2372. *Lansing* v. *Smith,* 8 Cow. 146.

But we are pressed with the argument, that for every damage which one sustains, which is caused by the wrongful act of another, he ought to have a remedy. This is far from being universally true. Another maxim in regard to claims for damage is, *causa proxima, non remota, spectatur.* Thousands of instances occur, in which one sustains consequential and incidental damage from the misconduct of another, without a remedy at law. By the misconduct of the officers or agents of a parish, town, county, or even of the State or the Union, defalcations may take place, treasure be squandered and wasted, and all the members of the respective aggregate bodies suffer damage, for which the law, from the nature of the case, can afford no direct remedy. But the true answer to the objection is, that stockholders have a remedy, a theoretic one indeed, and perhaps often inadequate, in the power of the corporation, in its corporate capacity, to obtain redress for injuries done to the common property, by the recovery of damages; and each individual stockholder has his remedy, through the powers thus vested in the corporation, for the common benefit.

On the whole, the court are of opinion that the demurrer is well taken, and that the action cannot be maintained.

GENERAL RUBBER CO. *v.* BENEDICT.

215 N.Y. 18. 1915.

CARDOZO, J. This case comes here on a demurrer to a complaint. The plaintiff is a corporation. It is organized under the laws of New Jersey. The defendant is one of its directors. There is another corporation, organized in the same State, known as General Rubber

Company of Brazil. The capital stock of the latter company is made up of three thousand shares; and all the shares, with the exception of eighteen, are held and owned by the plaintiff. For convenience, we shall refer to the plaintiff as the holding, and the General Rubber Company of Brazil as the subsidiary company. The general manager of the subsidiary company at Para, Brazil, was one Arnold J. Hutter. While acting as manager for that company, he became the manager of a rival business. This business was conducted at first under the name of E. Levy, and later, after a corporation had been organized, under the name of the Moju Company. The defendant was the owner of more than one-fourth of the stock. He was also its vice-president. The Moju Company met with reverses, and finally became insolvent. To relieve its embarrassments, Hutter, according to the allegations of the complaint, took the moneys of the General Rubber Company of Brazil and gave them from time to time to the Moju Company. The defalcations extended over a period of more than a year, and caused a loss of $185,000. The charge is made that the defendant knew of this misuse of moneys, and that he acquiesced in it and approved of it. He neglected, it is said, to inform the plaintiff of Hutter's wrongdoing; he withheld and concealed the truth, so it is charged, intentionally and for his own profit; and the averment is that if such information had been given, the plaintiff could and would have prevented the misapplication and the loss. Because of this violation of his duty, the value of the plaintiff's shares in the subsidiary company is said to have been lessened, and the plaintiff to have been otherwise damaged, in a sum exceeding $185,000. For the amount of this loss with interest, judgment is demanded.

The foregoing summary states in briefest outline the averments of a voluminous complaint. It suffices, however, to indicate the problem of law which is involved. We are to determine whether the defendant is liable to the holding company for the diminished value of its shares resulting from the waste of the assets of the subsidiary company.

The defendant was not a director of the subsidiary company. He *was* a director of the plaintiff. Because of that relation he owed to the plaintiff the duty of good faith and vigilance in the preservation of its property. The duty and the breach, coupled, it is here alleged, with damage, make out a cause of action. *Ashby* v. *White*, 3 Ld. Raym. 320. Such cases as *Smith* v. *Hurd*, 12 Metc. 375, and *Niles* v. *N.Y.C. & H.R. R.R. Co.*, 176 N.Y. 119, are pressed upon us by the defendant. They are inapplicable here. The distinction was well put by TAFT, J., writing for the Circuit Court of Appeals in *Ritchie* v. *McMullen*, 79 Fed. Rep. 522, 533: "It is undoubtedly true, as the Circuit Court held, that a stockholder, merely as such, cannot have an action in his own behalf against one who has injured the corpora-

tion, however much the wrongful acts have depreciated the value of his shares (citing *Smith* v. *Hurd, supra,* and other cases). But we are of opinion that this principle has no application where the wrongful acts are not only wrongs against the corporation, but are also violations by the wrongdoer of a duty arising from contract or otherwise, and owing directly by him to the stockholders." The stockholder in those cases did not sue his own agent. He sued another's agents, *i.e.*, the directors of a company, and sued them for the waste of the company's property. In his own right, and not in a derivative action, he attempted to recover his own damages, which he measured by the diminution in the value of his shares. The decision was that the delinquent directors were the agents of the company; that they owed a duty to the company and not to the individual stockholders; and that if there had been any breach of that duty the company must redress the wrong. But here the situation is a different one. Here the stockholder is not suing the agent of another company; it is suing its own agent. The stockholder happens to be itself a corporation; the defendant happens to be a director; but the legal problem would be the same if the plaintiff were a natural person, and the defendant an executor or trustee. It would also be the same if the plaintiff, instead of being substantially the sole stockholder, were one stockholder among many. If the trustee of an estate, holding shares in a bank, should learn that the cashier was looting it, and with that knowledge should keep silent, the defendant would have us say that the beneficiaries under the will would have no remedy for the ensuing loss. A trustee in the case supposed would owe no duty of active vigilance to the bank whose property was stolen. If not liable to those interested in the estate, he would not be liable to any one. Yet his duty to preserve the estate, the breach of that duty, and the resulting damage, would seem to call for the application of the principle that there is no wrong without a remedy. The case supposed does not differ in its essence from the case presented. The defendant, as a director of a corporation should have taken the same care of its property that men of average prudence take of their own property. *Hun* v. *Cary*, 82 N.Y. 65; *Latimer* v. *Veader*, 20 App. Div. 418, 428; *Bosworth* v. *Allen,* 168 N.Y. 157. A jury might not unreasonably find that the care exacted by that rule would involve at least a warning that the subsidiary company was in the management of a thief, and that the value of the shares was vanishing. It is argued that even if the warning had been given, the plaintiff was only a stockholder in the subsidiary company, and hence was not in a position to stop the waste. The allegation is, however, that it could and would have done so; and we must hold this sufficient on demurrer. There are many things it could have done. It could at least have sounded an alarm that might have led to Hutter's removal. The trial will show whether its intervention would or would not have

been efficient. In any event, we cannot say, and least of all as a matter of law, that the opportunity to intervene was valueless. *Leather Mfrs. Bank* v. *Morgan*, 117 U.S. 96, 115; *Continental Nat. Bank* v. *Nat. Bank of Commonwealth*, 50 N.Y. 575; *Voorhis* v. *Olmstead*, 66 N.Y. 113, 118; *Rothschild* v. *Title Guarantee & Trust Co.*, 204 N.Y. 458; *Cassidy* v. *Uhlmann*, 170 N.Y. 505, 518, 521.

It is strongly argued, however, that the defendant is answerable for the same wrong to the subsidiary company, and is thus exposed to the risk of a double liability. We think the wrong to the plaintiff does not cease to be remediable because it may also be a wrong to some one else. If the defendant has violated any duty to the subsidiary company, it is not the same duty that he owes to the plaintiff. He is not liable to the subsidiary company *qua* director. He is not liable to that company for mere neglect. He is liable to it, if at all, only as a stranger might be liable. If he has joined in a conspiracy to plunder it, he must, like any other tort feasor, make compensation for the plunder. There are allegations in the complaint which are broad enough to be construed as charging that he was a party to such a conspiracy. We cannot know whether they will be proved. If they are proved in all their fullness, they will show that the subsidiary company as well as the plaintiff has been wronged. Less, however, may be proved; the defendant may not have counseled or ratified Hutter's acts, or otherwise made himself a party to them; and still if he knew of them, and was silent, he may have failed in the stricter duty that he owes to the plaintiff. It is not for us at this time to say to what extent the duties are coterminous. It is enough that they have a different origin, a different standard, and a different measure.

The argument is made, however, that since the duties overlap, a double liability is threatened. To-day the defendant is called upon to make good the diminished value of the plaintiff's shares. To-morrow he may be called upon at the suit of the subsidiary company to replenish its wasted treasury. We think the argument confuses the cause of action with the damages. If the defendant is solvent, and has so made himself a party to the conspiracy that he is liable as a tort feasor to the subsidiary corporation, the existence of such a cause of action will be reflected, like the ownership of any other asset, in the value of the shares. The diminution in value will be one thing if the subsidiary corporation is without a remedy against any one. It will be another thing if there is a remedy against a solvent wrongdoer. It will be one thing if the cause of action in favor of the company is conceded or certain. It will be another thing if the cause of action is contested or doubtful. A contested claim is rarely appraised at its face value. The expenses of litigation, its delays, its uncertainties, these and like elements may make the shares less valuable, even though a remedy at the suit of the company exists, than

they would be if the wasted moneys were back in the treasury. The extent of the reduction in value is to be measured by the jury. We must keep in mind steadfastly the essential nature of the cause of action. It is not an action to restore to the subsidiary company the money that has been abstracted. It is an action to restore to the holding company the diminished value of its shares. If the subsidiary company were suing the defendant for a conversion of its assets, it would, of course, be no answer for him to say that there was a remedy also against Hutter. He would be bound to restore what he had taken, or permitted others to take. It is possible that if his offense was merely one of negligence, he might through subrogation have a remedy over against the principal offender. *Steele* v. *Leopold*, 135 App. Div. 247, 256, 257; aff'd., 201 N.Y. 518; *Chillingworth* v. *Chambers*, L.R. [1896] 1 Ch. 685; *Moxham* v. *Grant*, L.R. [1900] 1 Q.B. 88. But in this action he is under a very different duty. Nothing has been taken directly from the plaintiff. What has been taken belongs to the subsidiary company. The defendant is not sued for a wrongful taking. He is sued for the wrongful failure to preserve the value of the plaintiff's shares. Only to the extent that the taking has made the individual shares less valuable, has a liability arisen. In such circumstances there is no right of action in favor of the plaintiff against the primary wrongdoer to which the defendant can be subrogated. The ultimate devolution of the burden must, therefore, be determined, not in some other action, but here and now. In these conditions, it becomes our duty, through a sound definition of the measure of damages, to work out a result which will be just alike to plaintiff and to defendant.

The existence of a cause of action does not depend, however, upon the extent of the recovery. If the subsidiary company has no remedy that will enable it to make good the loss, the reduction in the value of the shares may be equal to the fund converted. If it has a plain and certain remedy either against the defendant or against some other solvent party to the wrong, the reduction in the value of the shares may be less than the converted fund, or, it may be, almost nominal. We can imagine a case where a director has borrowed money illegally, and may, therefore, be required to repay it. The corporation in such circumstances has a cause of action to compel the money to be restored, yet the value of the shares in the hands of the stockholders may not be reduced at all. Whatever difficulty there is in determining the measure of the loss is inherent in the very nature of these problems of appraisal. To determine the value of the shares, every asset of the subsidiary company must be reckoned, and the defendant's liability to that company, if it exists, must be included like any other.

We think, for these reasons, that the menace of a double liability is illusory. The defendant owes a duty to the plaintiff; if the com-

plaint speaks truly, he has violated that duty; and to the extent of the resulting damage he must answer for the wrong.

Collin, J. (dissenting). The facts alleged as constituting a cause of action at law in favor of the plaintiff against the defendant, adequately stated for the purposes of this discussion, are: The plaintiff, a New Jersey corporation, owned, as an asset, all the three thousand shares of the capital stock of another corporation hereinafter denominated the Brazil company, except eighteen. The defendant was a director of the plaintiff. He was not a director of or connected with the Brazil company. An agent of the Brazil company, wrongfully and without the knowledge of it or the plaintiff and with the knowledge, acquiescence and approval of the defendant, abstracted from time to time, through the period of about one year, from its treasury and delivered to a third corporation, the Moju Company, moneys aggregating $185,000, no part of which has been repaid to the Brazil company. The defendant owned about one-quarter of the issued shares of the capital stock, and was the vice-president of the Moju Company. The defendant did not inform the plaintiff, which remained ignorant, while it progressed, of the misapplication of the moneys of the Brazil company. The plaintiff, had it known of the misuse, "could and would have taken such action as would have caused the funds and moneys (of the Brazil company) theretofore so misapplied to have been recovered and as would have prevented the said further misapplication of said funds and moneys to such wrongful uses." The Moju Company is insolvent. The misappropriations by the agent of the Brazil company of its moneys have lessened the value of the assets of the plaintiff, to wit, the shares of stock of the Brazil company in a sum exceeding $185,000. Judgment for the said sum of $185,000 with interest is prayed for.

Certain facts are clear. This is an action at law. The Brazil company was an independent legal being or entity, and its status was unaffected by the ownership of the plaintiff of its capital stock. *Buffalo Loan, T. & S. D. Co.* v. *Medina Gas & E. L. Co.*, 162 N.Y. 67, 76; *Saranac & L. P. R.R. Co.* v. *Arnold*, 167 N.Y. 368. The Brazil company owned exclusively the abstracted moneys. The plaintiff did not at law have right, title or interest in or to them, the whole title of which was in the despoiled corporation. *United States Radiator Corp.* v. *State of New York*, 208 N.Y. 144. The plaintiff, by virtue of its shares of the capital stock of the Brazil company, had merely the right to partake, proportionately, of the surplus profits or fund of the company as declared or distributed by its directors. *Burrall* v. *Bushwick R.R. Co.*, 75 N.Y. 211; *Plimpton* v. *Bigelow*, 93 N.Y. 592, 599; *United States Radiator Corp.* v. *State of New York*, 208 N.Y. 144. The action is not derivative, that is, it is not brought in behalf of the Brazil company. The pith of the alleged cause of action

is, the abstraction of the moneys and the neglect of the defendant to inform the plaintiff of it.

The injury to the assets of the plaintiff was not direct, and came from and through the injury to those of the Brazil company. Those assets were not taken or directly injured or interfered with. They, as it is alleged, were depreciated in value by the "wrongful misappropriation" of the funds of the Brazil company, no part of which the plaintiff then owned or had a right to possess or control or has now the right to recover. The Brazil company owned them and was entitled to possess and dispose of them and it alone has the right to recover them. Whenever recovery or restitution of them is made to it, the alleged injury to the plaintiff will be obliterated. The subsequent disposition of them will be wholly within the authority of the Brazil company and it may naturally and lawfully result, through the hazards of business, that the plaintiff will not receive directly or indirectly any advantage from them. If at the commencement of this action the Moju Company or Hutter, the general manager and despoiler of the Brazil company, or this defendant had paid that company the sum abstracted, the plaintiff would not have had the alleged cause of action, because the plaintiff has no right to those moneys and upon their return to their owner, the Brazil company, it is not under any damages. If the defendant should pay the sum of them or any part to this plaintiff, he, under the allegations of the complaint, which permit proof that the defendant conspired with the agent of the Brazil company, would remain liable to the Brazil company for them, because they were taken from and belong to the Brazil company, but if he paid them to the Brazil company, he would not thereafter be liable to the plaintiff, because it had no right to them and its damage or loss would have been wholly remedied. There was but a single loss, although that loss may indirectly and collaterally affect the creditors and stockholders of the one loser, to wit, the Brazil company. A single recovery by the Brazil company would afford complete indemnity to the plaintiff and all interested parties. Each of the Brazil company and the plaintiff has not the right to recover the one hundred and eighty-five thousand dollars. The general rule of the law is, that an action must be brought by the person having the title to the damages which are sought to be recovered for the injury and not the person or persons who are indirectly damaged by it.

If the defendant at his first knowledge of the spoliation during its progress had informed the plaintiff of it, the plaintiff would not have had the right to any of those moneys or any damages, a fact which the complaint recognizes in the averment that if he had done so "the plaintiff could and would have taken such action as would have caused the funds and moneys (of Brazil company) theretofore so misapplied to have been recovered and as would have prevented the

said further misapplication of said funds and moneys to such wrongful uses." The quoted allegation is a conclusion of law based upon the ownership by the plaintiff of nearly all of the capital stock of the Brazil company, but treating it as an allegation of fact, there remains the truth that the plaintiff has not been injured by the neglect of the defendant. The power and authority which it then had to cause the Brazil company to recover the misapplied funds, it still has. While the Moju Company is insolvent, Hutter, the agent of the Brazil company, and this defendant, presumptively, are solvent. Solvency of the individual, no refuting circumstance appearing, is presumed. *First National Bank of Meadville* v. *Fourth National Bank, N.Y. City*, 77 N.Y. 320; *Potter* v. *Merchants' Bank of Albany*, 28 N.Y. 641. The plaintiff in proving the alleged cause of action would prove a cause of action in favor of the Brazil company against Hutter and this defendant, as tort feasors, through which that company could recover the full amount of the funds appropriated by them with interest — a result the equivalent of that obtainable under full and immediate information of the misappropriation to the plaintiff by the defendant. The plaintiff is seeking to recover, through the alleged wrong of the defendant, a sum which it never had, and would not have had if the defendant had told it all that he knew, which is recoverable by the Brazil company, and the recovery of which by that company will make whole the value of the plaintiff's shares of its stock. The law does not permit such a result.

In *Wells* v. *Dane*, 101 Me. 67, the plaintiff was a shareholder in the corporation, and brought the action against the defendants, officers of the corporation, to recover damages, alleging that the wicked and wrongful acts were with the specific intent and malicious and fraudulent design of injuring the plaintiff. The court held that the plaintiff did not have a cause of action, and for reasons which I think determine the question here in accord with complete and final justice. It said: "There may be cases of injuries to the individual rights of the shareholder where he and not the corporation must seek redress, such for instance as the levying of an unlawful tax on shares held by the individual stockholder, mutilation or destruction of his certificate, or circulating false and scandalous reports or issuing spurious certificates thus creating uncertainty as to the title or validity of existing shares. In all such cases, however, the wrongful act affects the shares directly. They are readily distinguished from the case at bar, where the plaintiff claims his shares were depreciated by wrongful acts making possible the issue of six hundred shares of stock without payment therefor. Such a wrong being primarily against the corporation, the redress for it must be sought by the corporation. . . . Whatever injury befell him he suffered as a stockholder; and in a case like this, where the direct injury was to corporate rights and interests, the right to share in the

compensation which the corporation may recover passes to the transferee of the plaintiff's shares. *Winsor* v. *Bailey*, 55 N.H. 218. Neither does it matter that the misconduct is charged against the defendants as individuals and not as officers. By whomsoever the wrongful acts were committed and in whatsoever capacity the wrongful doers acted, their acts directly injured the corporate body. Redress must be sought by the party injured. The plaintiff was injured only indirectly and collaterally. When the corporation is indemnified the plaintiff ceases to be a loser. It is for this reason, viz., that the plaintiff sustained no loss in addition to the loss to the corporation, that the action cannot be maintained notwithstanding the allegation that the wrongful acts were done with the specific intent and malicious and fraudulent design of injuring the plaintiff. If the plaintiff had suffered any loss in addition to that suffered by the corporation such an allegation would be sufficient although the injury suffered was indirect and consequential. *Gregory* v. *Brooks*, 35 Conn. 437; *St. J. & L. C. R. Co.* v. *Hunt*, 55 Vt. 570. In those cases a wrongful act was done to one with an unlawful intent and design to indirectly injure another, and both were injured. Here there is but one loser and one injury. When the injury is to the collective rights of the shareholders and the corporate property is made good, the plaintiff, who has suffered only in these, will be fully indemnified. There is therefore nothing for which he can maintain a separate suit. Where there is but one loss and one loser there can be but one suit, and that must be by the party who has suffered the loss." See, also, *Allen* v. *Curtis*, 26 Conn. 456; *Niles* v. *N.Y. C. & H. R. R.R. Co.*, 176 N.Y. 119.

The gist of the wrong in any aspect is the abstraction of the moneys which were those of the Brazil company, and that company's ownership of the damages resulting from it. It is true that in the present case the defendant was a director of the shareholder, and it is alleged that such relation gave an additional element to his wrongdoing, making him liable to the plaintiff. But the fundamental facts exist that the direct and primary injury and single loss is to the Brazil company; that the loss to the plaintiff was simply an indirect consequence of that loss and not additional to or independent of it; that the Brazil company can recover its loss and that being done the plaintiff will be fully indemnified. The fact that the despoilers of the Brazil company were not its directors does not affect the natural results of their acts and is immaterial. *Wells* v. *Dane*, 101 Me. 67; *Converse* v. *United Shoe Mach. Co.*, 185 Mass. 422.

The case of *Ritchie* v. *McMullen*, 79 Fed. Rep. 522, does not conflict with the foregoing reasoning and conclusions. There the defendant directors of the corporation were pledgees of the plaintiff's shares of its capital stock, and combined together and wrongfully reduced the value and income of the pledged shares with the intention of

defaulting the pledgor, forcing the shares to a public sale, depriving the plaintiff of the means of redeeming them or buying them in, of buying them in at less than their value, and of thus increasing their holdings and causing the plaintiff to cease to be a stockholder and lose the benefits from his development of the properties. The basis of the decision there was that the pledgees used their positions as majority directors and their votes as stockholders intentionally to depreciate the stock of their pledgor with the dishonest purposes as mentioned. Clearly, the injury to the plaintiff was direct and peculiar. The case, in this aspect, belongs to the class of which is *St. J. & L. C. R. Co.* v. *Hunt*, 55 Vt. 570. For the reasons stated, I vote for reversal.

CHASE, MILLER and SEABURY, JJ., concur with CARDOZO, J.; COLLIN, J., reads dissenting opinion, and HISCOCK, J., concurs; WILLARD BARTLETT, Ch.J., absent.

Order affirmed.

G. Dealings with Third Persons.

McCLURE v. LAW.

161 N.Y. 78. 1899.

HAIGHT, J. This action was brought to recover of the defendant, a former president and director of the Life Union, the sum of $3,000, which the plaintiff claims was profits made by the defendant out of his trust relationship with the company. The facts established by the evidence are, in substance, as follows: An agreement was entered into on the 28th day of December, 1891, between one Horace Moody, party of the first part, and Lucius O. Robertson and Lewis P. Levy, parties of the second part, by which the party of the first part undertook to deliver to the parties of the second part the absolute control and management of the Life Union Association in consideration of the sum of $15,000. This was to be accomplished by the resignation, from time to time, of one or more directors of the corporation and the election of the parties of the second part, or the persons that they should designate, as directors. This agreement was entered into by Moody under the directions of the defendant, for whom he was acting as agent and attorney. It was modified on the 5th day of February, 1892, with reference to details in payments, etc., but not in any respect affecting the question here presented. These agreements were subsequently executed. Mr. Levy was elected a director to fill a vacancy theretofore existing, and then the defendant resigned as president and had Mr. Levy elected in his place. Subsequently, the defendant, with other directors from time

to time resigned, and their places were filled by persons designated by Levy. The money was paid over to a person designated by the defendant and then was distributed among the directors, the defendant receiving $3,000. His excuse for this proceeding was that this transfer was made for the purpose of reimbursing himself and other directors for moneys that they had theretofore invested in the purchase of promissory notes which had been issued by the corporation for the purpose of purchasing the property and assets of the Flour City Life Association of Rochester. The notes, however, were, by their terms, payable out of the expense funds to be derived from the transfer membership of the Flour City Association, and inasmuch as the transfer was never effected, the notes were not collectible from the Life Union. *McClure* v. *Levy*, 147 N.Y. 215. The defendant held three of these notes of $1,000 each, but they cannot be accepted as a justification of the transaction, or be received as a defense to this action. The question is, therefore, presented, whether the defendant is bound to account for the money received from Levy for the transfer to him and his associates of the management and control of the Life Union, together with its property and effects. The learned Appellate Division has treated this transaction as a bribe paid to the directors of the Life Union by Levy, and reached the conclusion that the money did not belong to the corporation. We think, however, that the law does not permit the defendant to avail himself of his own wrong as a defense to this action. As president and director of the Life Union he was bound to account to that association for all moneys that came into his hands by virtue of his official acts, and he cannot be permitted to shield himself from such liability under the claim that his acts were illegal and unauthorized. As an officer he had the right to resign, but the money was not paid to him for his resignation. It was paid over upon condition that he procure Levy and his friends to be elected directors and given the control and management, together with the property and effects of the corporation. The election of directors and the transfer of the management and property of the corporation were official acts, and whatever money he received from such official acts were moneys derived by virtue of his office for which we think he should account.

In *Sugden* v. *Crossland*, 3 Sm. & Gif. 192, Horsefield was a trustee under a will. Crossland paid him seventy-five pounds to withdraw from the trust and have Crossland appointed in his place. It was held that the seventy-five pounds belonged to the estate.

Perry on Trusts, at § 427, says: "Trustees hold a position of trust and confidence, the legal title to the trust property is in them, and generally its whole management and control is in their hands. . . . They cannot use the trust property nor their relation to it for their own personal advantage. All the power and the influence which the possession of the trust fund gives must be used for the

advantage and profit of the beneficial owners and not for the personal gain and emoluments of the trustees. . . . So, where a trustee retired from the office in consideration that his successor paid him a sum of money, it was held that the money so paid must be treated as a part of the trust estate, and that the trustee must account for it as he could make no profit directly or indirectly from the trust property or from the position or office of trustee."

In Cook on Corporations, § 650, it is said: "It is a well-established principle of law that a director commits a breach of trust in accepting a secret gift or secret pay from a person who is contracting or has contracted with the corporation, and that the corporation may compel the director to turn over to it all the money or property so received by him." See, also, *Chandler* v. *Bacon*, 30 Fed. Rep. 538; *Rutland El. L. Co.* v. *Bates*, 68 Vt. 579; *Farmers & Merchants' Bank* v. *Downey*, 53 Cal. 466; *Sheridan* v. *Sheridan El. Light Co.*, 38 Hun, 396.

The order of the Appellate Division should be reversed and judgment entered on the verdict affirmed, with costs in all courts.

All concur, except PARKER, Ch.J., not sitting, and BARTLETT, J., dissenting.

Order reversed, etc.

NOTE. — *Landes* v. *Hart*, 131 N.Y. App. Div. 6. A contract by a director of X with A, under the terms of which A is to pay the director a sum of money for procuring a contract between X and A, is illegal, even if the other directors know the facts. See also *Billings* v. *Shaw*, 209 N.Y. 265.

Pearson's Case, L.R. 5 Ch.D. 336. A director of a company received from one of the promoters a number of paid-up shares sufficient to qualify him as a director, and then took an active part in carrying out a conditional contract for the purchase by the company of a colliery belonging to the promoters. JESSEL, M.R., held that he must account to the company for the value of the shares, saying (p. 340): "That being the position of Sir Edwin Pearson, can he be allowed to say in a Court of Equity that he, having received a present of part of the purchase money, and being knowingly in the position of agent and trustee for the purchasers, can retain that present as against the actual purchasers? It appears to me that, upon the plainest principles of equity and good conscience, he cannot. Whether the purchase was or was not an advantageous one for the company, whether the property which they purchased at this large profit was or was not worth the increased price that they paid for it, is a question wholly immaterial for us to consider; he cannot, in the fiduciary position he occupied, retain for himself any benefit or advantage that he obtained under such circumstances. He must be deemed to have obtained it under circumstances which made him

liable, at the option of the *cestuis que trust*, to account either for the value at the time of the present he was receiving, or to account for the thing itself and its proceeds if it had increased in value. The company elect on the present occasion to ask to charge him with the value of the twenty-five share warrants at the time of their delivery."

In re London & South Western Canal, Limited, [1911] 1 Ch. 346. Directors who accept and hold their qualification shares in trust for and at the will of the promoter, to whom they hand blank transfers, are guilty of misfeasance, and the measure of damages is the highest value of the shares during their holding.

In *Godley* v. *Crandall & Godley Co.*, 212 N.Y. 121, the court said (p. 131): "There is authority and sound reason in support of the proposition that, in the absence of some provision of statute, by-law or charter, the directors have no authority to vote salaries to each other as mere incidents of their office."

H. Executive Officers.

JACOBUS *v.* JAMESTOWN MANTEL CO.

211 N.Y. 154. 1914.

CHASE, J. This action is brought on a promissory note, of which the following is a copy:

"$2,500.00 NEW YORK, *Oct.* 8, 1909.

"Six months after date we promise to pay to the order of ourselves, Two thousand five hundred & 00/100 dollars at Newton Trust Co., Newton, N.J., value received.

"JAMESTOWN MANTEL CO.

"GEO. M. TURNER, *Treas.*"

Said note was indorsed "Jamestown Mantel Co., Geo. M. Turner, Treas.," and it was thereafter delivered to and discounted by the Newton Trust Company, the assignor of the plaintiff. It is the last one of a series of like notes, the original of which was given in August, 1907. At the times herein mentioned the trust company had an investment committee consisting of Hough, its president, Searing, its vice-president, and George, a director. Searing and George were partners doing business in New York city. In August, 1907, Searing was the president of the Delaware and Eastern Railroad Company. One Welch, an attorney at law, had done business as such for said railroad company and for Searing individually. Welch asserted that the railroad company and Searing owed him considerable money for services; he told Searing that he needed money for his immediate use, and Searing said to him that the company was not in a position

to pay him at that time, but that if he would borrow a note from somebody for a short time, he, Searing, would have it discounted at one of his trust companies. Welch went to Turner and told him that he wanted to borrow a note of the Jamestown Mantel Company for $2,500 to have it discounted, and that if he, Turner, would furnish him with such a note he would take care of it when it was due.

Turner in the name of the mantel company, and in the form shown, made and indorsed a note for $2,500, and gave it to Welch. Welch delivered it to Searing, who sent it to the trust company, and received in return for it a draft of $2,425, being the amount of the note less the discount thereon. Searing retained the proceeds of the draft and told Welch that his trust companies were not in funds to discount the note. Before the note became due, however, Searing told Welch that the note had been actually discounted and that he had used the money. It was thereafter renewed from time to time until the note now in suit became due when further renewals were refused by the mantel company and it also refused to pay the note.

The defendant was in no way directly or indirectly interested in the transaction. The note was given in its name wholly without authority. If Searing was acting for and on behalf of the trust company, it is of course chargeable with his knowledge that the note was borrowed for discount to accommodate Welch and Searing and the defendant is not liable thereon. If he was not acting for and on behalf of the trust company then he was acting independently of it and the trust company is in no way chargeable with his knowledge or information.

The first question for consideration on this appeal is whether the knowledge of Searing, under the circumstances disclosed, is attributable to the trust company. We think not.

Searing conceived the idea of obtaining money from the trust company on a note to be borrowed for the purpose, and he was the one actively engaged in carrying out the plan. In carrying it out he was reckless of the consequences to the trust company. In all the transaction he acted for himself individually or in his capacity as president of the Delaware and Eastern Railroad Company. There was no meeting of the investment committee of the trust company and no action thereon by it as a committee. Searing acted at his place of business and not at the place of business of the trust company, and wholly independent of his official relation to it. His knowledge was intentionally concealed from the trust company with the fraudulent purpose probably formed at the time the note was first suggested of retaining the proceeds thereof for himself. If we admit that the evidence is insufficient to justify the conclusion that Searing intended to keep the proceeds of the note for his personal use when he first suggested to Welch that he borrow a note to be discounted,

it must at least be conceded that he either intended at that time to obtain the money for his personal use or to use it for the benefit of the corporation of which he was president. Searing is a lawyer, and he must have known that the note being entirely apart from the business of the corporation was not a binding obligation upon it. In any event the concealment of his knowledge from the trust company was necessary to enable him to obtain from it the proceeds of a note which he knew had been executed without authority, and which would at least be of doubtful value in the hands of the trust company. The trust company should not be held cognizant of his knowledge. *Brooklyn Distilling Co.* v. *Standard Dis. & Dist. Co.*, 193 N.Y. 551.

There are other objections to the plaintiff's recovery upon the note that are fatal to his contention. The defendant is a domestic manufacturing corporation. A corporation is an artificial entity having only such powers as are given to it by law and such implied powers as are necessary to the exercise of the powers expressly given to it. The defendant was organized to "manufacture wood mantels, interior finish, bank, office and bar fixtures and generally to carry on any manufacturing business which can conveniently be carried on in conjunction with any of the matters aforesaid." The treasurer of the defendant corporation had no express authority by its by-laws or otherwise to sign or indorse a promissory note. The president of the trust company had never had a transaction with the defendant corporation and did not know its treasurer. He does not remember that Searing said anything to him whatever at the time the note was sent to him for discount. It was taken by him on behalf of the trust company without inquiry either as to the responsibility of the corporation or as to the authority of its treasurer to make a promissory note even in the usual course of its business. It affirmatively appears as we have seen that the treasurer had no express authority to make a promissory note, and that the note as made was not made in the regular transaction of the business of the corporation, but wholly as an accommodation to a friend of such treasurer.

A manufacturing corporation has no power to make or indorse notes for the accommodation of others. *National Park Bank of N.Y.* v. *Ger. Am. M. W. & S. Co.*, 116 N.Y. 281; *Fox* v. *Rural Home Co.*, 90 Hun, 365; affd. on opinion below, 157 N.Y. 684. One who deals with the officers or agents of a corporation is bound to know their powers and the extent of their authority. *Alexander* v. *Cauldwell*, 83 N.Y. 480. Notwithstanding the general rule stated, a corporation is bound if it makes or indorses commercial paper for the accommodation of another in respect to a *bona fide* holder who discounts it before maturity on the faith of its being business paper. *Mechanics' Banking Association* v. *N.Y. & S. White Lead Co.*, 35

N.Y. 505. The decision in the *White Lead Co. Case, supra*, and other similar decisions are based upon the assumption that the officers making or indorsing a promissory note had authority from the corporation to make and indorse such notes in the ordinary course of its business. Such decisions do not apply to a case where the officers purporting to act for a corporation do not have authority to sign commercial paper in the ordinary course of its business. A treasurer of a manufacturing corporation has no power to make promissory notes in its name unless such power is expressly given to such officer by the by-laws of the corporation or by resolution of its board of directors. Thompson on Corporations (2d ed.), § 1564; Daniels on Negotiable Instruments (5th ed.), vol. 1, § 394; Edwards on Bills, § 65; Beach on Private Corporations (2d ed.), vol. 2, § 804; *McCullough* v. *Moss*, 5 Denio, 567; *National Bank of Newport* v. *Snyder Mfg. Co.*, 107 App. Div. 95; *Niagara Falls Susp. Bridge Co.* v. *Bachman*, 66 N.Y. 261; *Dabney* v. *Stevens*, 40 How. Pr. 341; *Marine Bank* v. *Clements*, 3 Bosw. 600; *National Bank of the Republic* v. *Navassa Phosphate Co.*, 56 Hun, 136; *People's Bank* v. *St. Anthony's R. C. Church*, 109 N.Y. 512. No presumption existed that the defendant's treasurer had power to make or indorse business paper. It was necessary, therefore, for the plaintiff to show that the treasurer had authority to execute promissory notes in the name of the corporation in the ordinary course of its business, or that the defendant was estopped from denying such authority.

It is urged that there is some evidence that the treasurer of the defendant had on one or more occasions signed a promissory note in its name in the regular course of defendant's business, and that such note or notes had thereafter been paid by the corporation. It does not appear that said treasurer had ever signed such a note prior to the execution of the note which was given in August, 1907. Whether he had done so or not is of little importance for the purpose of creating an estoppel against the defendant because it affirmatively appears that the trust company did not know of any of the acts claimed to have been done by the defendant's treasurer in its name.

If the defendant had, prior to August, 1907, in the usual course of its business permitted its treasurer from time to time to make promissory notes in its name which it ratified and approved by paying them, and knowledge of such acts had come to the trust company, and it had relied upon such acts as showing authority in the defendant's treasurer to make promissory notes in its name in taking the note in controversy, a question of estoppel would have arisen as against the defendant in this action.

It is essential for one claiming that another is equitably estopped from denying liability because of his previous acts and conduct to show that he was influenced by and relied upon such acts and conduct on making the promise or performing the act upon which the

liability is asserted. *Draper* v. *Oswego Co. Fire R. Assn.*, 190 N.Y. 12, 16. The defendant is not estopped from denying its liability in this case. If the president of the trust company had made inquiry in regard to the practice of the defendant in making promissory notes and the authority of its treasurer to sign its name to such notes, and he had ascertained all the facts presented by the record, there would have remained a question of fact as to whether the inquiry was a reasonable one, and whether the facts shown were sufficient to warrant the action of the trust company in discounting the note in question.

It may also be assumed that the record presents a question of fact as to whether Turner as the treasurer of the corporation had authority to sign promissory notes in the usual course of defendant's business by reason of one or more notes having been signed by him which were thereafter paid by the corporation.

The plaintiff at the trial insisted that the court direct a verdict, and it having directed a verdict for the defendant the plaintiff is bound by the decision of the court upon all questions of fact then open for its determination.

There is evidence on which the trial court was authorized to make the findings necessary on which to base its direction of a verdict for the defendant.

The judgment should be affirmed, with costs.

WILLARD BARTLETT, Ch.J., WERNER, HISCOCK, COLLIN, HOGAN and MILLER, JJ., concur.

Judgment affirmed.

NOTE. — By the weight of authority, the treasurer of a corporation has not, by virtue of his office, authority to borrow money or issue obligations of the corporation. As to the law of Massachusetts, however, see *Merchants' Bank* v. *Citizens' Gas Light Co.*, 159 Mass. 505.

A president has no authority, by virtue of his office, to execute a mortgage on the corporate property. *Frederick* v. *Letteney*, 214 Mass. 46. A president of a building construction company has no authority, by virtue of his office, to award subcontracts on construction work for which his company has the main contract. *Murphy* v. *W. H. & F. W. Cane, Inc.*, 80 N.J.L. 163.

The vice-president of a trust company acting as trustee under a mortgage has no authority, by virtue of his office, to make representations as to what property the mortgage covered. *Davidge* v. *Guardian Trust Co.*, 203 N.Y. 331, 339. A vice-president of a corporation owning and operating an amusement park has no authority, by virtue of his office, to contract for the purchase of the corporation's own capital stock and bonds. *Beach* v. *Palisade Amusement Co.*, 86 N.J.L. 238. Cf. *Prairie du Rocher* v. *Milling Co.*, 248 Ill. 57.

The secretary of a newspaper corporation has no authority, by virtue of his office, to make a certificate of publication for such corporation. *Chicago* v. *Stein*, 252 Ill. 409. The secretary of a corporation has no authority, by virtue of his office, to alter the terms of a contract made by the corporation with a third person. *Scott* v. *New York Filling Co.*, 79 N.J.L. 231.

As to the authority of a general passenger agent, see *Parrot* v. *Mexican Central Railway*, 207 Mass. 184. As to the authority of a superintendent, see *Hall* v. *Passaic Water Co.*, 83 N.J.L. 771.

As to action by an executive committee see *Young* v. *Canada S.S. Co., Ltd.*, 211 Mass. 453. As to delegation of the entire management to one man, see *Cumberland Trust Co.* v. *Ayars & Sons Co.*, 83 N.J. Eq. 479.

CHAPTER II.

STOCKHOLDERS.

SECTION 1.

RIGHTS OF A STOCKHOLDER EVEN WHEN HE IS IN THE MINORITY.

A. To inspect the Corporate Books and Records.

VARNEY v. BAKER.

194 Mass. 239. 1907.

KNOWLTON, C.J. This is a petition for a writ of mandamus to obtain an examination of the books of account of the defendant corporation. The petitioner is the owner of eighty shares of the capital stock of the corporation, the whole number of shares being three hundred and fifty. The respondent Baker admitted that he told the son of the petitioner, three or four months before the petition was filed, that the company had lost several thousand dollars. The truth of the statement was not denied, although officers of the company testified that, at the time of the hearing, the company was in a prosperous condition.

The single justice who heard the case found that the petitioner honestly believes that the company is being mismanaged, and desires in good faith, for the protection of his interest in the corporation, to examine the books and records of the company for the purpose of ascertaining its condition and the value of its stock, and of determining what to do with his stock, and whether there has been mismanagement of the corporation, and if so, what effect it has had upon the assets and business of the corporation, in order that he may be enabled to bring a bill in equity for the appointment of a receiver, or to take other proper proceedings for the benefit of the corporation and of his interest therein. He also found that an examination could be conducted without interfering unduly with the business of the corporation. It was not proved to the satisfaction of the justice that there was any mismanagement in fact, or any incapacity on the part of the managing officers. The justice reserved the case for our determination, and his report presents the question of law whether, on

these facts, the petitioner should have an opportunity to examine the books of account and deposit of the corporation, and if so, to what extent.

The stockholders of a corporation are the equitable owners of its assets, and the officers act in a fiduciary relation as agents of the corporation and of the stockholders. They should be ready to account to the stockholders for their doings at all reasonable times, and the stockholders have a right to inspect their records and accounts, and to ascertain whether they are faithful, honest and intelligent in the performance of their duties. There is no good reason why the stockholders, acting in good faith for the purpose of advancing the interest of the corporation and protecting their rights as owners, should not be permitted to examine the corporate property, including the books and accounts.

It was formerly held in England that this right could be exercised, against the will of the managing officers, only when there was a specific dispute about some corporate matter, between the stockholders and the officers. *Rex* v. *Merchant Tailors' Co.*, 2 B. & Ad. 115. But this rule has been modified by statute. See St. 8 & 9 Vict. c. 16, §§ 117, 119, and St. 25 & 26 Vict. c. 89, Table A 78. The doctrine has not been adopted in America, the cases which go furthest in that direction holding that a dispute as to the alleged mismanagement of the corporation is enough to entitle the stockholder to an examination of the accounts to see whether there is a ground for an action. *Commonwealth* v. *Phœnix Iron Co.*, 105 Penn. St. 111; *Phœnix Iron Co.* v. *Commonwealth*, 113 Penn. St. 563. According to the general rule in this country, it is not necessary that there should be any particular dispute to entitle the stockholder to exercise this right. Nothing more is required than that, acting in good faith for the protection of the interests of the corporation and his own interests, he desires to ascertain the condition of the company's business. *Guthrie* v. *Harkness*, 199 U.S. 148; *In re Steinway*, 159 N.Y. 250; *Huylar* v. *Cragin Cattle Co.*, 13 Stew. (N.J.) 392; *State* v. *Pacific Brewing & Malting Co.*, 21 Wash. 451; *Cockburn* v. *Union Bank of Louisiana*, 13 La. Ann. 289; *State* v. *Laughlin*, 53 Mo. App. 542; *Heminway* v. *Heminway*, 58 Conn. 443. See *Union Bank* v. *Knapp*, 3 Pick. 96, 108.

Of course the right at common law is not absolute, so that it can be exercised for mere curiosity, or for merely speculative purposes, or vexatiously. If the court is appealed to for the enforcement of the right, a sound discretion will be exercised to determine whether the petitioner is acting for an honest purpose, not adverse to the interests of the corporation. The court will consider whether his desire for an examination is reasonable, having reference to the interests of the corporation and his personal interest as a member of it. Its effect upon the corporation in reference to competitors and other interests will not be disregarded. But as was stated in *Dunphy* v. *Traveller*

Newspaper Association, 146 Mass. 495, "Courts of equity are swift to protect helpless minorities of stockholders of corporations from the oppression and fraud of majorities."

In the present case the findings of the justice show that the petitioner should be permitted to examine the books in accordance with his request. His right to such an examination includes the right to have the assistance of an expert, or other person, if he desires to make transcripts from the books for subsequent use.

There is nothing in our statutes which enlarges or diminishes this right as it exists at common law. The provision of the St. 1903, c. 437, § 30, relates only to the copies, books and records therein referred to, and is not applicable to the present case.

Peremptory writ of mandamus to issue.

NOTE. — In *Huylar* v. *Cragin Cattle Co.*, 40 N.J. Eq. 392, the court said (p. 398): "They are entitled to such inspection, though their only object is to ascertain whether their affairs have been properly conducted by the directors or managers. Such a right is necessary to their protection. To say that they have the right, but that it can be enforced only when they have ascertained, in some way without the books, that their affairs have been mismanaged, or that their interests are in danger, is practically to deny the right in the majority of cases. Oftentimes frauds are discoverable only by examination of the books by an expert accountant." See also *Matter of Steinway*, 159 N.Y. 250, 263; *Neubert* v. *Armstrong Co.*, 211 Pa. 582; *Guthrie* v. *Harkness*, 199 U.S. 148.

Cf. *Lyon* v. *American Screw Co.*, 16 R.I. 472.

HENRY *v.* BABCOCK & WILSON CO.

196 N.Y. 302. 1909.

WILLARD BARTLETT, J. The defendant is a corporation organized under the laws of New Jersey, having its main office for the transaction of business in this state at No. 85 Liberty street in the borough of Manhattan in the city of New York where it keeps its stock book. On January 17, 1908, during the usual hours of business, the plaintiff, being a resident of New York and the owner of one share of stock in said corporation, demanded of its treasurer, who was the officer having charge of the stock book, "to be allowed to inspect the said stock book and to copy therefrom the names of the persons therein set down as stockholders of the defendant together with their places of residences and the number of shares of stock held by them respectively." The treasurer asked the plaintiff his purpose in making the request. This the plaintiff declined to state, saying that

he understood his right was absolute under the law. The treasurer thereupon said: "If you will tell me your purpose and if such purpose appears to me to be proper I will then allow you to inspect the stock book but not otherwise." The plaintiff still declined to disclose his purpose whereupon the treasurer finally refused the desired inspection.

This controversy was then stated between the parties and duly submitted to the Appellate Division, the plaintiff contending that the refusal to permit an inspection of the defendant's stock book entitled him to recover a penalty of $250 under section 53 of the Stock Corporation Law. The Appellate Division has rendered judgment in favor of the defendant and from that judgment the plaintiff now appeals.

Section 53 of the Stock Corporation Law, as in force at the time of this transaction (now section 33 of chapter 59 of the Consolidated Laws) provided that every foreign corporation having an office for the transaction of business in this state should keep a stock book containing a list of its stockholders, showing their places of residence, the number of shares of stock held by them respectively, etc. It further provided as follows: "Such stock book shall be open daily, during business hours, for the inspection of its stockholders. . . . For any refusal to allow such book to be inspected, such corporation and the officer or agent so refusing shall each forfeit the sum of two hundred and fifty dollars ($250) to be recovered by the person to whom such refusal was made." Laws of 1892, ch. 688, § 53, as amended by Laws of 1897, ch. 384.

Referring to those cases in which it has been held that the courts in the exercise of their discretion may properly refuse to compel by mandamus the production of the books of a corporation for inspection by a stockholder where it does not appear that the inspection is sought for a legitimate purpose, the learned judge who wrote the prevailing opinion below saw no reason why the same rule should not be adopted in the present case. He thought that the plaintiff's refusal to disclose his motive authorized the inference that the motive was improper; and that the desired permission to inspect and copy was rightfully denied, not only for that reason, but because the statute did not expressly entitle a stockholder to copy the names and addresses of the other holders of stock from the stock book.

In *Matter of Steinway*, 159 N.Y. 250, the question certified to this court for decision was: "Has the Supreme Court the power, upon the petition of a stockholder, to compel by mandamus the corporation to exhibit its books for his inspection?" In the opinion of the court, Judge VANN carefully inquired into the origin and extent of the authority of the Supreme Court and its power of visitation or of examining into the affairs of corporations according to the common law; and the conclusion was reached that the common-law right of

a stockholder with reference to the inspection of the books of his corporation still exists unimpaired by legislation, and that the Supreme Court has power, in its sound discretion upon good cause shown, to enforce such right. That decision, so far as it goes, tends to sustain the position of the appellant; but it did not pass upon the force and effect of the statute whose operation is invoked in the present case.

No doubt the legislature could make the stockholder's privilege of inspection dependent upon the motive or purpose with which it is sought; but it has not seen fit to do so. The language of the statute is plain and mandatory. It recognizes an absolute right in the stockholder and imposes an absolute duty upon the corporation and the custodian of the stock book. The law requires no statement or proof of any particular intent upon the part of the person demanding the inspection. He must be a stockholder and must prefer his request during business hours; that is all. If it appeared in good faith that the book was then in actual use for other corporate purposes, he could, of course, be required to wait a reasonable time until such use terminated; but no such matter of defense is suggested here. The plaintiff was refused any inspection at all in the absence of a disclosure of his purpose; and this action of the defendant has been sanctioned by the judgment of the Appellate Division. We think that judgment is based upon a mistaken construction of the statute in this respect. Nor was the refusal justified on the ground that the law confers upon the stockholder no express right to copy from the book. The right to inspect the book includes the right on the part of the stockholder to aid his memory by copying therefrom to the extent indicated in the agreed statement of facts in the present case. In *Cotheal* v. *Brouwer*, 5 N.Y. 562, it was held that the custodian of a register of stockholders which the stockholder had a statutory right to examine could not close the book because a stockholder desired to make a memorandum in the course of his examination in order to assist his recollection. "Unless the stockholder is permitted to take memorandums from the books," said PAIGE, J., "or copies of the names of the stockholders, the plain object of the statutory provision would be defeated" (p. 567).

The judgment of the Appellate Division should be reversed and judgment directed for the plaintiff in accordance with the terms of the submission, with costs in both courts.

CULLEN, CH.J., VANN, WERNER, HISCOCK and CHASE, JJ., concur; GRAY, J., not voting.

Judgment reversed, etc.

NOTE. — See, *accord*, *Cobb* v. *Lagarde*, 129 Ala. 488; *Venner* v. *Chicago City Ry. Co.*, 246 Ill. 170; *Kimball* v. *Dern*, 39 Utah, 181; *Davies* v. *Gas Light Co.*, [1909] 1 Ch. 708.

B. To Dividends.

GOODNOW *v.* AMERICAN WRITING PAPER CO.

73 N.J. Eq. 692. 1907.

SWAYZE, J. The appellant filed his bill to have a resolution for the payment of a dividend upon the preferred stock of the defendant declared unlawful, null and void, and to restrain payment thereof. The bill charges that the capital stock of the company was for the most part issued for property purchased, which included trade-marks and good will taken at a grossly excessive valuation, and that whatever the value of the property given in exchange for the stock may have been at the time of purchase, it now falls short of the aggregate of the debts and the par value of the stock; that the operations of the company have been successful, and to some extent profitable, a considerable sum of money having been earned in excess of the interest upon the mortgage, and of the $100,000 required annually to be set aside as a sinking fund for the mortgage bonds, and of the cost of operating the company and keeping up its manufacturing plant; that the net annual gains as reported by the directors to the stockholders prior to 1906 were used in part to purchase the company's own bonds for its treasury and for the sinking fund, and in part were set aside for working capital; and that on July 1st, 1906, the balance sheet of the company showed accumulated profits to an amount several times the amount required to pay the proposed dividend; that the dividend was authorized by resolution of October 2, 1906 (1905 in the printed case seems to be a clerical error), which directed the treasurer to pay the dividend out of net profits on April 1, 1907. The gravamen of the bill is that the payment of this dividend would constitute a division and withdrawal and payment to the holders of preferred shares of a part of the capital stock of the company, and would constitute an unlawful reduction of the capital stock in violation of the Corporation Act.

To this bill the defendant demurred, and the court of chancery allowed the demurrer.

We think it unnecessary to discuss the question dealt with by the learned vice-chancellor as to the right of the stockholders to raise this question, or the question so thoroughly discussed at the bar as to the meaning of net profits under our Corporation Act as it stood prior to the enactment of chapter 143 of the Laws of 1904. The question seems to us to involve only the construction of that act, and to turn upon the change introduced thereby. Cases cited from other jurisdictions are therefore of little assistance.

The material language in the act of 1896 (P.L. 1896, p. 286) is as follows: "No corporation shall make dividends, except from the surplus or net profits arising from its business, nor divide, withdraw, or in any way pay to the stockholders, or any of them, any part of its capital stock, or reduce its capital stock, except according to this act."

In the act of 1904 this section is changed so as to read as follows: "The directors of a corporation shall not make dividends except from its surplus, or from the net profits arising from the business of such corporation, nor shall it divide, withdraw, or in any way pay to the stockholders, or any of them, any part of the capital stock of such corporation, or reduce its capital stock except as authorized by law."

Under the act of 1896 there was room to contend that the words "net profits" were intended to be synonymous with the word "surplus"; the language used was "from the surplus or net profits." Under the act of 1904, this contention is no longer possible; the language used is "from its surplus, or from the net profits." The evident intent of the change is to point out two funds from which dividends may be made.

Although the change in language indicates that the legislature made a distinction between surplus and net profits, it does not necessarily follow that net profits mean the difference between gross earnings and what may be called operating expenses. Such profits may be called annual profits, and it may be that by net profits the legislature meant the net profits upon the whole of the company's business from its organization. If either of these meanings is adopted, the declaration of the present dividend is justified. There was an excess of gross earnings over the operating expenses of the current year, and the value of the present assets exceeded the value of the actual assets with which the company began business. The complainant contends, however, that the term "net profits" is used in neither of these senses, but in the sense of an excess of the value of the present assets over the par value of the capital stock issued and outstanding; and the claim is that since that stock was issued for property at a gross overvaluation, there can be no dividend until the difference between the actual value of the property and the value at which it was taken over is made up. The argument is that the intent of § 30 is to prevent the capital stock being distributed in the form of dividends, and the words "capital stock" are supposed to be used in that section as synonymous with "share capital."

The ambiguity in the term "capital stock" was noticed by this court in *Wetherbee* v. *Baker*, 35 N.J. Eq. (8 Stew.) 501. It may mean either the capital subscribed (the share capital) or the capital paid in, the actual assets with which the company does business. It seems to be used in both senses in this very section. When the legislature

forbids the dividing, withdrawing or paying to the stockholders any part of the capital stock it means the capital actually invested; when it forbids the reduction of capital stock it means the share capital subscribed, or the authorized capital.

We are led to the conclusion that the words "capital stock" in the first instance mean capital actually invested, by the fact that it is only actual assets that can be divided, withdrawn, or paid over. These words are not apt words to apply to nominal or share capital, which may be reduced, but can hardly be withdrawn, divided, or paid over. This capital actually invested does not include net profits arising from the business of the company, for the reasons that the language of the section itself makes a distinction between the declaration of dividends and of profits and the withdrawing of capital; that another method of securing payment of the par value of the stock is provided in other sections of the act; that the policy to be served by the prohibition of § 30 is to prevent the frittering away of the actual assets with which the company is to do business, not the nominal assets which it has never received and for which it still has a claim against the subscribers for unpaid stock. The section distinguishes between surplus and net profits; but if the complainant is correct in his contention that net profits mean only the excess above the share capital, we see no distinction in fact, but only in bookkeeping entries.

It may not infrequently happen that stock is issued on which avowedly only a partial payment is made of the amount subscribed, which is therefore subject to further calls. We cannot think that in such a case, where the company prospers, there are no net profits available for dividends until the earnings accumulate to an amount equal to the par value of the shares. The complainant's brief concedes this, and the concession seems quite fatal to his argument.

The language of § 47 supports this view. It requires the directors, after reserving over and above its capital stock paid in such sum as shall have been fixed as a working capital, to declare a dividend of the whole accumulated profits. Here the profits are clearly to be ascertained by reference to the capital stock paid in, and not to the nominal share capital. It would be quite inconsistent to require by § 47 a dividend out of profits to be ascertained with reference to capital stock paid in, and to forbid by § 30 a dividend, unless there were net profits over and above the amount of the nominal share capital.

NOTE. — In *Roberts* v. *Roberts-Wicks Co.*, 184 N.Y. 257, the court said (p. 266): "Dividends, as the rule, are not payable out of the capital of a corporation, but only from the surplus profits arising from the business carried on, and that was the contract here. When the property of a corporation has accumulated in excess of its char-

tered capital, the excess may be regarded and dealt with as constituting a surplus of profits."

If assets are wasting in their nature, as mines or patents, a sinking-fund to offset the waste may not be necessary. See *Excelsior Mining Co.* v. *Pierce*, 90 Cal. 131; *Mellon* v. *Mississippi Glass Co.*, 77 N.J. Eq. 498; *People* v. *Roberts* 156 N.Y. 585; *Lee* v. *Neuchatel Asphalte Co.*, L.R. 41 Ch.D. 1.

McNAB *v.* McNAB & HARLIN MFG. CO.

62 Hun (N.Y.) 18. 1891.

Daniels, J. The defendant was incorporated on or about the 28th of April, 1871, under the laws of this State providing for the incorporation of manufacturing companies. Its business was declared to be that of manufacturing brass and iron goods for sale, and since its incorporation it has carried on that business. The plaintiff was the owner of eight shares of its capital stock, which consisted of one hundred and fifty shares, of $1000 each, and the other defendants were officers and shareholders in the company. After its formation, and in or about the year 1877, the company became unable to pay its debts, and a proceeding in bankruptcy was instituted to discharge it from its debts. Soon after the proceeding was commenced the defendant Harlin became the president of the company. He owned seventy-eight shares of its capital stock, and compromised the debts owing to the creditors of the company. The agreement for the compromise was to pay seventy-five per cent within the period of three years. After he took charge of the affairs of the company as its president, and under his management, the business became prosperous, and the seventy-five per cent was paid to the creditors, and afterwards they were paid the additional sum of twenty-five per cent, making payment of their demands in full. The prosperity of the company continued, owing to the judicious management of the president, and for eight years prior to the time of the trial, which took place in May, 1891, its net profits amounted to the sum of $100,000 a year, or a sum slightly in advance of that amount, and from the year 1881 to the year 1891 it made and paid a dividend on its shares amounting to an average exceeding the sum of twenty-five per cent; and, in addition to the dividends made in this manner, it accumulated a large surplus, which was mainly used in its business, but to the extent of about one hundred thousand dollars was in its deposit accounts. And it was stated by the treasurer in his evidence upon the trial that there was at that time an actual surplus owned by the company amounting to the sum of $152,209, and the plaintiff, whose action was brought to secure the distribution of the surplus by way of dividends, alleged and claimed that a still larger surplus

had been earned and was owned by the company; and it was one of the principal objects of the action to secure the division of this surplus by way of dividends among the shareholders. But it was proved in the course of the trial that the surplus maintained by the company was profitably employed in purchasing the material used by it in the course of its manufactures, and that it was considered for the best interests of the company not to divide this surplus among the shareholders. The directors, in restricting the dividends as they did, seem to have been impressed with the propriety of this conviction, and the dividends were accordingly limited to such amounts from year to year as did not intrench upon the large surplus which had been earned and secured. In their action upon this subject the trustees appear to have exercised the judgment which they deemed to be most consistent with the prosperity and maintenance of the interests of the company, and the statute under which the incorporation took place delegated the authority of the trustees to manage the stock, property, and concerns of the company (2 Rev. St., 5th ed., p. 503, § 29); and to what amount the dividends shall be made, and the extent of the surplus which the interests of the company may require to be retained, are within this delegation of authority confided to the trustees. And it was so regarded in *Williams* v. *Telegraph Co.*, 93 N.Y. 162, where it was said, with the apparent approval of the court, that "when a corporation has a surplus, whether a dividend shall be made, and, if made, how much it shall be, and when and where it shall be payable, rest in the fair and honest discretion of the directors, uncontrollable by the courts." Id. 192. And no broader principle than this was either stated or sanctioned in *Scott* v. *Fire Co.*, 7 Paige, 198, or in either of the other authorities which have been brought to the attention of the court. The principle to be applied is that which shall secure the observance of good faith on the part of the directors, and this principle was neither denied nor intrenched upon in *Seeley* v. *Bank*, 8 Daly, 400, which was affirmed in 78 N.Y. 608. The trustees are chosen by the shareholders, to exercise their best judgment, depending upon their knowledge of the affairs and condition of the company; and when that has been done, the courts do not undertake to control their action, although they might differ in their views of the proper management to be adopted and followed. No reason has been disclosed by the case for doubting or impeaching the good faith of these trustees. Neither can it be affirmed justly, in view of the large business carried on by the company, that they acted unreasonably or capriciously in declining to order a larger dividend than that which was in fact paid to the shareholders.

NOTE. — In *Burland* v. *Earle*, [1902] A.C. 83, the court said (p. 95): "Their Lordships are not aware of any principle which

compels a joint-stock company while a going concern to divide the whole of its profits amongst its shareholders. Whether the whole or any part should be divided, or what portion should be divided and what portion retained, are entirely questions of internal management which the shareholders must decide for themselves, and the court has no jurisdiction to control or review their decision, or to say what is a 'fair' or 'reasonable' sum to retain undivided, or what reserve fund may be 'properly' required. And it makes no difference whether the undivided balance is retained to the credit of profit and loss account, or carried to the credit of a rest or reserve fund, or appropriated to any other use of the company. These are questions for the shareholders to decide subject to any restrictions or directions contained in the articles of association or by-laws of the company."

In the United States, the authorities in *accord* with the reasoning and result of the principal case are very numerous. But the courts have jurisdiction to compel the declaration of a dividend, and will do so in a proper case. See *Crichton* v. *Webb Press Co.*, 113 La. 167; *Cratty* v. *Peoria Ass'n*, 219 Ill. 516 (preferred stock); *Blanchard* v. *Prudential Insurance Co.*, 78 N.J. Eq. 471 (and cases cited); *Matter of Rogers*, 161 N.Y. 108, 112; *Morey* v. *Fish Bros. Wagon Co.*, 108 Wis. 520.

On the right of preferred stockholders to dividends see *Equitable Life Assurance Society* v. *Union Pacific R.R. Co.*, 212 N.Y. 360.

On the mooted question as to whether, in a suit to compel the declaration of a dividend, the directors must be made parties, see *Purchase* v. *Atlantic Safe Deposit Co.*, 81 N.J. Eq. 344, 346 (as a corporation can only act through its board of directors, a duty of the corporation "necessarily belonged to the board and to each member of the board"); *Wilson* v. *United States*, 21 U.S. 361, 376 ("a command to the corporation is in effect a command to those who are officially responsible for the conduct of its affairs").

It is *ultra vires* for a corporation to guarantee dividends on its own stock. See *Strickland* v. *National Salt Co.*, 79 N.J. Eq. 182.

FORD *v.* EASTHAMPTON RUBBER THREAD CO.

158 Mass. 84. 1893.

Contract for money had and received. At the trial in the Superior Court, without a jury, before Aldrich, J., there was evidence tending to show that the plaintiff on June 16, 1891, owned fifty-two shares of the capital stock of the defendant company, of the par value of one hundred dollars per share; that on that day the directors passed the following vote, namely, "That a dividend of 20 per cent be paid to

stockholders of this date, payable Tuesday, June 23d, 1891"; that on said June 16th the annual meeting of stockholders of the company for the election of directors was held immediately after the meeting of directors, according to custom, and duly elected five directors, as provided by the by-laws of the company, two only of the old directors being re-elected, and no director being re-elected who voted for the twenty per cent dividend, though the two who were re-elected were present at the meeting when it was voted; and that on said June 16th, as soon as the stockholders' meeting adjourned, the directors elected and re-elected thereat met, qualified, organized for the year, and passed the following votes: "That the vote passed by the directors of this company this day declaring a dividend of 20 per cent on the capital stock of the company, payable Tuesday, June 23d, 1891, be reconsidered and rescinded; the same is hereby rescinded. That a dividend of six per cent, payable June 23d instant to stockholders of record this day, be declared in place of the dividend voted at earlier meeting of this board this day." It also appeared that no money was set aside or provided to pay said dividend of twenty per cent, but the company had ample means and facilities for paying the twenty per cent dividend; that always before money had been provided to pay a dividend before it was declared; that money to pay said six per cent dividend was provided after the meeting and before said 23d of June by borrowing, and the same was set aside and deposited in bank therefor; that the treasurer sent the check of the defendant on the bank where the money was deposited to each stockholder of record of said June 16th to pay the dividend on his stock at six per cent, including the plaintiff, on said 23d June, 1891; and that the plaintiff declined to accept the check, and returned the money to the treasurer. It further appeared in evidence that no stockholder of the defendant had been paid the twenty per cent dividend for June, 1891; that a majority of the stockholders had accepted the dividend of six per cent paid by checks as aforesaid on June 23, 1891, in full; that the plaintiff, by his attorney, by letter of June 30, 1891, demanded payment of the twenty per cent dividend from the defendant; and that the plaintiff made no objection to the check of the defendant sent him to pay the dividend of June 16, 1891, except that it was for a dividend of six per cent, instead of twenty per cent.

The defendant asked the court to rule that the directors elected on June 16 had a right on that day to rescind the vote whereby the twenty per cent dividend was declared payable at a future day; and that the plaintiff could not recover. The judge declined so to rule, ordered judgment for the plaintiff, and reported the case for the determination of this court. If the refusal to rule and order of judgment were correct, judgment was to be affirmed; otherwise, judgment was to be ordered for the defendant.

Field, C.J. It seems to be settled that, when a dividend has been

fully declared, the corporation thereby manifests its intention that the amount of the dividend should be considered as having been separated from the other property of the corporation, and as having become the individual property of the stockholders, and that therefore, when the dividend becomes payable according to the terms of the vote declaring it, each stockholder has a right to demand payment of the proportional part of the dividend which belongs to his shares of stock, and to sue the corporation for it, if it is not paid on demand. In some cases money or other property equal to the whole amount of the dividend declared has been specifically set apart as a fund appropriated to the payment of the dividend, and the stockholders have been regarded as the *cestuis que trust* of this fund, each entitled to his share. In other cases, the corporation has credited the stockholders with the amount of their shares of the dividend, and the stockholders have assented to this, and the amount so credited has been regarded as a debt of the corporation to the stockholders; or the corporation has paid to some of the stockholders their shares of the dividend, and has refused to pay anything to the others, and it has been held that the corporation must pay all alike. See *Beers* v. *Bridgeport Spring Co.*, 42 Conn. 17; *State* v. *Baltimore & Ohio Railroad*, 6 Gill, 363; *King* v. *Paterson & Hudson River Railroad*, 5 Dutch. 504; *Jermain* v. *Lake Shore & Michigan Southern Railway*, 91 N.Y. 483; *Hopper* v. *Sage*, 112 N.Y. 530; *Jackson* v. *Newark Plankroad Co.*, 2 Vroom, 277; *Wheeler* v. *Northwestern Sleigh Co.*, 39 Fed. Rep. 347. When a dividend has been declared payable at a definite future time, but no fund has been set apart for the payment of the dividend, and the corporation meanwhile becomes insolvent, whether the stockholders to the extent of their proportions of the dividend should share ratably with the creditors of the corporation in its property has not, so far as we know, been recently considered, but the decision in *Lowene* v. *American Ins. Co.*, 6 Paige, 482, is that they should. The setting apart of a fund to pay a dividend has been held to give a lien upon it to the stockholders, which they can enforce to the exclusion of the general creditors of the corporation. *In re Le Blanc*, 14 Hun, 8, and 75 N.Y. 598; *Le Roy* v. *Globe Ins. Co.*, 2 Edw. Ch. 657. The English Companies' Act, 1862 (25 & 26 Vict. c. 89, § 38, cl. 7), provides that "no sum due to any member of a company, in his character of a member, by way of dividends, profits, or otherwise, shall be deemed to be a debt of the company, payable to such member in a case of competition between himself and any other creditor not being a member of the company; but any such sum may be taken into account, for the purposes of the final adjustment of the rights of the contributories amongst themselves." Upon these questions, however, we desire to express no opinion.

It has been argued that there is no consideration for the promise of a corporation to pay a dividend to its stockholders, but we think that

the doctrine of consideration applicable to a simple contract between persons having no fiduciary relations to each other is not applicable to such promise. It is the object of a private business corporation to make money for its stockholders, and, under our laws, it is ordinarily the duty of the directors from time to time to declare dividends out of the net earnings, if there are any, and it must be left largely to the discretion of the directors to determine when and for how much such dividends should be declared. The whole property of the corporation is held on a sort of trust for the stockholders, and the directors are, in a general sense, the managers; and when a dividend is declared by the directors, the declaration is a determination by a body authorized to make it that the amount of the dividend should be taken from the property of the corporation and paid over to the stockholders. The cause of action of each stockholder against the corporation for non-payment of the dividend does not arise from any actual contract between the corporation and its stockholders, but from the nature of the organization, and the relation of the stockholders to the corporation and its property. Unless the rights of creditors intervene, or the corporation is enjoined from paying the dividend, on the ground that the dividend has not been earned, or on some other ground, the amount of the dividend, after it has been declared and has become payable, is considered as property held by the corporation for the use of the stockholders individually, and the stockholders may recover their shares as money or property had and received to their use. We have been able to find little or no authority on the precise question involved in this case, namely, whether, after a dividend has been duly declared by a vote of the directors, but payable at a future time, the vote can be rescinded at a subsequent meeting of the directors, held before the time at which the dividend becomes payable according to the vote, when the fact that a dividend has been declared has not been made public, or in any manner communicated to the stockholders, and when no fund has been set apart for the payment of the dividend. On principle, we do not see why the directors may not rescind such a vote, under the circumstances stated. By the vote no specific property passed to the stockholders. If the vote be regarded as a declaration of trust in favor of the stockholders, it could be revoked before it was communicated to them or any property was identified and set aside for them. Indeed, cases may easily be supposed of such a change in the affairs of a corporation, between the time when a dividend is declared and the time when it becomes payable, as to make the exercise of such a power by the directors useful, if not necessary, for the successful continuance of the business of the corporation. It appears in the present case that the meeting of the new directors at which the vote was rescinded was held after the annual meeting of the stockholders, but on the same day as the meeting of the directors at which the vote was passed, which was

held just before the meeting of the stockholders; and that at the meeting of the stockholders "the president did not, as had for many years been the custom, announce that any dividend had been declared, or promulgate the same to the stockholders"; and it does not appear that any of the stockholders, except the directors, knew of the original vote, or that any of the stockholders had made any contracts, incurred any liability, or done anything relying on the vote. It also appears that no fund was distinctly set apart for the payment of the dividend before the vote was rescinded. As the passage of the vote did not constitute an actual contract of the corporation with its stockholders, but was merely a mode of dividing the earnings of the property of the corporation among the stockholders, we are of opinion that before the division had been actually made, and before the position of the stockholders had been changed in reliance on the vote, — certainly before the passage of the vote had been made public, or communicated to the stockholders, — it was within the power of the directors, at a meeting subsequent to that at which the vote was passed, to rescind it. In this action at law, we cannot supervise the exercise of this power by the directors.

Judgment for the defendant.

NOTE. — Cf. *McLaran* v. *Planing Mill Co.*, 117 Mo. App. 40.

BURROUGHS *v.* NORTH CAROLINA R.R. CO.

67 N.C. 376. 1872.

RODMAN, J. On 16th February, 1870, the North Carolina Railroad Company declared a dividend by the following resolution: "The Board of Directors of the North Carolina Railroad Company do declare an annual dividend of six per cent on the capital stock of this company, for the fiscal year ending the 31st of May, 1870. Three per cent to be paid on 1st April, and three per cent payable on the first day of July, 1870, and the transfer books be closed from first day of March to the first of April, and from the first day of June until the first day of July."

On the 17th February, the plaintiffs, in writing in the usual form, at the foot of their certificate for thirty-four shares of stock in the company, transferred the same to Samuel H. Wiley for value, and authorized F. A. Stagg, attorney, to transfer the same on the books of the company. The transfer was accordingly made on the 21st February. The certificate of stock to the plaintiffs was cancelled, and a new certificate issued to Wiley. On the same day plaintiffs notified the company that they claimed the dividend declared on 16th February. The company, nevertheless, paid the same to Wiley, and

this action is brought to recover it. One would suppose, that in a case which must be of frequent occurrence, there would be proved some established usage, or that some decided cases could be found fixing the rights of the parties. If there be any established usage, either general or special to this corporation, there has been no evidence of it offered in this case. And the learned counsel inform us that they have been able to find no authority whatever on it. The absence of authority is the more remarkable, as the rule as to a dividend following the stock or not, under the present circumstances, would seem to be of a general nature, not confined to sales, but covering the case of a life tenant with remainder, when the life tenant dies after the dividend is declared, and before it is payable, and the case of a will bequeathing stock, when the testator dies under the like circumstances.

Before proceeding to the particular consideration of this case, it is necessary to observe: —

1. It was clearly within the power of the seller and purchaser of the stock in this case, to have contracted with respect to the dividend declared on the day before. But,

2. If we assume for the moment, that the effect of the resolution declaring the dividend, was to make it payable to whoever should appear by the books of the company to be the owner of the stock on the days on which it was payable, then, notwithstanding any different contract between the plaintiffs and their vendee, the company was justified in paying to the vendee, and the redress of the plaintiffs would be by an action against their vendee for money had and received.

It is important to notice that the question is, not as to the contract between plaintiffs and Wiley, but, to whom did the company agree to pay the dividend; for if the company agree to pay to one who turned out to be Wiley, its liability cannot be affected by any collateral agreement between the plaintiffs and Wiley (even if there were express proofs of such) without its consent. Without adverting to the principle, that the contract between plaintiffs and Wiley must be supposed to have been made in reference to the resolution of the day before, as to which it does not appear that either party had any advantage in point of knowledge; yet, in the absence of a contrary agreement, the sale must necessarily have been of the subject-matter with its rights and incidents at the date, or perhaps when the transfer should be completed.

So that the true question is, what was the effect and meaning of the resolution? Did it mean that the dividend should be payable to those who held the stock on 15th February, or to those who should hold it on 1st April? If the resolution had been clear and explicit in either sense, I conceive there could be no room for a controversy. Being of uncertain meaning, the courts have to give it a certain one.

But whatever shall be determined to be its meaning in law, that must be taken to be as plainly its meaning as if it had been expressly written so.

What was the object in declaring the transfer books of the company closed from 1st March to 1st April?

If the dividend was intended to be payable to any one who was the holder on 16th February, there could be no sue in closing the books. In any case, upon a demand for payment, it would only be necessary to see from the books who was the holder on that day. But if the usage be, to put the dividend on the books of the company to the credit of the holders on 1st March, we can see a reason for closing the books, viz., to give time for the company to make out its accounts with its stockholders on that day. Suppose an assignment of stock between 1st March and 1st April, would the company be bound to notice it, in reference to a dividend payable 1st April? I think not.

NOTE. — Cf. *Hopper* v. *Sage,* 112 N.Y. 530.

Nisbet v. *Philp,* [1913] 2 Ch. 697. Where preference shares carrying a fixed cumulative preferential dividend are bequeathed in trust for a life tenant and remaindermen, and no dividend is declared or paid for the financial years including the life tenancy, the life tenant's executors are not entitled to have the arrears made good out of future preferential dividends.

C. To subscribe to New Issues of Stock.

STOKES *v.* CONTINENTAL TRUST CO.

186 N.Y. 285. 1906.

APPEAL from an order of the Appellate Division of the Supreme Court in the first judicial department, entered January 4, 1905, reversing a judgment in favor of plaintiff entered upon a decision of the court on trial at Special Term and granting a new trial.

This action was brought by a stockholder to compel his corporation to issue to him at par such a proportion of an increase made in its capital stock as the number of shares held by him before such increase bore to the number of all the shares originally issued, and in case such additional shares could not be delivered to him for his damages in the premises.

The defendant is a domestic banking corporation in the city of New York, organized in 1890, with a capital stock of $500,000, consisting of 5000 shares of the par value of $100 each. The plaintiff was one of the original stockholders, and still owns all the stock

issued to him at the date of organization, together with enough more acquired since to make 221 shares in all. On the 29th of January, 1902, the defendant had a surplus of $1,048,450.94, which made the book value of the stock at that time $309.69 per share. On the 2d of January, 1902, Blair & Company, a strong and influential firm of private bankers in the city of New York, made the following proposition to the defendant: "If your stockholders at the special meeting to be called for January 29, 1902, vote to increase your capital stock from $500,000 to $1,000,000 you may deliver the additional stock to us as soon as issued at $450 per share ($100 par value) for ourselves and our associates, it being understood that we may nominate ten of the twenty-one trustees to be elected at the adjourned annual meeting of stockholders."

The directors of the defendant promptly met and duly authorized a special meeting of the stockholders to be called to meet on January 29, 1902, for the purpose of voting upon the proposed increase of stock and the acceptance of the offer to purchase the same. Upon due notice a meeting of the stockholders was held accordingly, more than a majority attending either in person or by proxy. A resolution to increase the stock was adopted by the vote of 4197 shares, all that were cast. Thereupon the plaintiff demanded from the defendant the right to subscribe for 221 shares of the new stock at par, and offered to pay immediately for the same, which demand was refused. A resolution directing a sale to Blair & Company at $450 a share was then adopted by a vote of 3596 shares to 241. The plaintiff voted for the first resolution but against the last, and before the adoption of the latter he protested against the proposed sale of his proportionate share of the stock and again demanded the right to subscribe and pay for the same, but the demand was refused.

On the 30th of January, 1902, the stock was increased, and on the same day was sold to Blair & Company at the price named. Although the plaintiff formally renewed his demand for 221 shares of the new stock at par and tendered payment therefor, it was refused upon the ground that the stock had already been issued to Blair & Company. Owing in part to the offer of Blair & Company, which had become known to the public, the market price of the stock had increased from $450 a share in September, 1901, to $550 in January, 1902, and at the time of the trial, in April, 1904, it was worth $700 per share.

Prior to the special meeting of the stockholders, by authority of the board of directors a circular letter was sent to each stockholder, including the plaintiff, giving notice of the proposition made by Blair & Company and recommending that it be accepted. Thereupon the plaintiff notified the defendant that he wished to subscribe for his proportionate share of the new stock, if issued, and at no time did he waive his right to subscribe for the same. Before the special meeting, he had not been definitely notified by the defendant that he

could not receive his proportionate part of the increase, but was informed that his proposition would "be taken under consideration."

After finding these facts in substance, the trial court found, as conclusions of law, that the plaintiff had the right to subscribe for such proportion of the increase, as his holdings bore to all the stock before the increase was made; that the stockholders, directors, and officers of the defendant had no power to deprive him of that right, and that he was entitled to recover the difference between the market value of 221 shares on the 30th of January, 1902, and the par value thereof, or the sum of $99,450, together with interest from said date. The judgment entered accordingly was reversed by the Appellate Division, and the plaintiff appealed to this court, giving the usual stipulation for judgment absolute in case the order of reversal should be affirmed.

Vann, J. . . . The leading authority is *Gray* v. *Portland Bank*, decided in 1807 and reported in 3 Mass. 364. In that case a verdict was found for the plaintiff, subject, by the agreement of the parties, to the opinion of the court upon the evidence in the case whether the plaintiff was entitled to recover, and, if so, as to the measure of damages. The court held that stockholders who held old stock had a right to subscribe for and take new stock in proportion to their respective shares. As the corporation refused this right to the plaintiff he was permitted to recover the excess of the market value above the par value, with interest. In the course of its argument the court said: "A share in the stock or trust when only the least sum has been paid in is a share in the power of increasing it when the trustee determines or rather when the *cestuis que trustent* agree upon employing a greater sum. . . . A vote to increase the capital stock, if it was not the creation of a new and disjointed capital, was in its nature an agreement among the stockholders to enlarge their shares in the amount or in the number to the extent required to effect that increase. . . . If from the progress of the institution and the expense incurred in it any advance upon the additional shares might be obtained in the market, this advance upon the shares relinquished belonged to the whole, and was not to be disposed of at the will of a majority of the stockholders to the partial benefit of some and exclusion of others."

This decision has stood unquestioned for nearly a hundred years, and has been followed generally by courts of the highest standing. It is the foundation of the rule upon the subject that prevails, almost without exception, throughout the entire country.

[After reviewing the authorities.] If the right claimed by the plaintiff was a right of property belonging to him as a stockholder he could not be deprived of it by the joint action of the other stockholders and of all the directors and officers of the corporation.

What is the nature of the right acquired by a stockholder through

the ownership of shares of stock? What rights can he assert against the will of a majority of the stockholders and all the officers and directors? While he does not own and cannot dispose of any specific property of the corporation, yet he and his associates own the corporation itself, its charter, franchises, and all rights conferred thereby, including the right to increase the stock. He has an inherent right to his proportionate share of any dividend declared, or of any surplus arising upon dissolution, and he can prevent waste or misappropriation of the property of the corporation by those in control. Finally, he has the right to vote for directors and upon all propositions subject by law to the control of the stockholders, and this is his supreme right and main protection. Stockholders have no direct voice in transacting the corporate business, but through their right to vote they can select those to whom the law intrusts the power of management and control.

A corporation is somewhat like a partnership, if one were possible, conducted wholly by agents where the copartners have power to appoint the agents, but are not responsible for their acts. The power to manage its affairs resides in the directors, who are its agents, but the power to elect directors resides in the stockholders. This right to vote for directors and upon propositions to increase the stock or mortgage the assets, is about all the power the stockholder has. So long as the management is honest, within the corporate powers and involves no waste, the stockholders cannot interfere, even if the administration is feeble and unsatisfactory, but must correct such evils through their power to elect other directors. Hence the power of the individual stockholder to vote in proportion to the number of his shares is vital, and cannot be cut off or curtailed by the action of all the other stockholders even with the coöperation of the directors and officers.

In the case before us the new stock came into existence through the exercise of a right belonging wholly to the stockholders. As the right to increase the stock belonged to them, the stock when increased belonged to them also, as it was issued for money and not for property or for some purpose other than the sale thereof for money. By the increase of stock the voting power of the plaintiff was reduced one half, and while he consented to the increase he did not consent to the disposition of the new stock by a sale thereof to Blair & Company at less than its market value, nor by sale to any person in any way except by an allotment to the stockholders. The increase and sale involved the transfer of rights belonging to the stockholders as part of their investment. The issue of new stock and the sale thereof to Blair & Company was not only a transfer to them of one half the voting power of the old stockholders, but also of an equitable right to one half the surplus which belonged to them. In other words, it was a partial division of the property of the old stockholders. The

right to increase stock is not an asset of the corporation any more than the original stock when it was issued pursuant to subscription. The ownership of stock is in the nature of an inherent but indirect power to control the corporation. The stock when issued ready for delivery does not belong to the corporation in the way that it holds its real and personal property, with power to sell the same, but is held by it with no power of alienation in trust for the stockholders, who are the beneficial owners and become the legal owners upon paying therefor. The corporation has no rights hostile to those of the stockholders, but is the trustee for all including the minority. The new stock issued by the defendant under the permission of the statute did not belong to it, but was held by it the same as the original stock when first issued was held in trust for the stockholders. It has the same voting power as the old, share for share. The stockholders decided to enlarge their holdings, not by increasing the amount of each share, but by increasing the number of shares. The new stock belonged to the stockholders as an inherent right by virtue of their being stockholders, to be shared in proportion upon paying its par value or the value per share fixed by vote of a majority of the stockholders, or ascertained by a sale at public auction. While the corporation could not compel the plaintiff to take new shares at any price, since they were issued for money and not for property, it could not lawfully dispose of those shares without giving him a chance to get his proportion at the same price that outsiders got theirs. He had an inchoate right to one share of the new stock for each share owned by him of the old stock, provided he was ready to pay the price fixed by the stockholders. If so situated that he could not take it himself, he was entitled to sell the right to one who could, as is frequently done. Even this gives an advantage to capital, but capital necessarily has some advantage. Of course, there is a distinction when the new stock is issued in payment for property, but that is not this case. The stock in question was issued to be sold for money, and was sold for money only. A majority of the stockholders, as part of their power to increase the stock, may attach reasonable conditions to the disposition thereof, such as the requirement that every old stockholder electing to take new stock shall pay a fixed price therefor, not less than par, however, owing to the limitation of the statute. They may also provide for a sale in parcels or bulk at public auction, when every stockholder can bid the same as strangers. They cannot, however, dispose of it to strangers against the protest of any stockholder who insists that he has a right to his proportion. Otherwise the majority could deprive the minority of their proportionate power in the election of directors and of their proportionate right to share in the surplus, each of which is an inherent, preëmptive, and vested right of property. It is inviolable and can neither be taken away nor lessened without consent, or a waiver implying consent. The plain-

tiff had power, before the increase of stock, to vote on 221 shares of stock, out of a total of 5000, at any meeting held by the stockholders for any purpose. By the action of the majority, taken against his will and protest, he now has only one half the voting power that he had before, because the number of shares has been doubled while he still owns but 221. This touches him as a stockholder in such a way as to deprive him of a right of property. Blair & Company acquired virtual control, while he and the other stockholders lost it. We are not discussing equities, but legal rights, for this is an action at law, and the plaintiff was deprived of a strictly legal right. If the result gives him an advantage over other stockholders, it is because he stood upon his legal rights, while they did not. The question is what were his legal rights, not what his profit may be under the sale to Blair & Company, but what it might have been if the new stock had been issued to him in proportion to his holding of the old. The other stockholders could give their property to Blair & Company, but they could not give his.

A share of stock is a share in the power to increase the stock, and belongs to the stockholders the same as the stock itself. When that power is exercised, the new stock belongs to the old stockholders in proportion to their holding of old stock, subject to compliance with the lawful terms upon which it is issued. When the new stock is issued in payment for property purchased by the corporation, the stockholders' right is merged in the purchase, and they have an advantage in the increase of the property of the corporation in proportion to the increase of stock. When the new stock is issued for money, while the stockholders may provide that it be sold at auction or fix the price at which it is to be sold, each stockholder is entitled to his proportion of the proceeds of the sale at auction, after he has had a right to bid at the sale, or to his proportion of the new stock at the price fixed by the stockholders.

We are thus led to lay down the rule that a stockholder has an inherent right to a proportionate share of new stock issued for money only and not to purchase property for the purposes of the corporation or to effect a consolidation; and while he can waive that right, he cannot be deprived of it without his consent except when the stock is issued at a fixed price not less than par and he is given the right to take at that price in proportion to his holding, or in some other equitable way that will enable him to protect his interest by acting on his own judgment and using his own resources. This rule is just to all and tends to prevent the tyranny of majorities which needs restraint, as well as virtual attempts to blackmail by small minorities which should be prevented.

The remaining question is whether the plaintiff waived his rights by failing to do what he ought to have done, or by doing something he ought not to have done. He demanded his share of the new stock

at par, instead of at the price fixed by the stockholders, for the authorization to sell at $450 a share was virtually fixing the price of the stock. He did more than this, however, for he not only voted against the proposition to sell to Blair & Company at $450, but as the court expressly found, he "protested against the proposed sale of his proportionate share of the stock and again demanded the right to subscribe and pay for the same, which demands were again refused," and "the resolution was carried notwithstanding such protest and demands." Thus he protested against the sale of his share before the price was fixed, for the same resolution fixed the price and directed the sale, which was promptly carried into effect. If he had not attended the meeting, called upon due notice to do precisely what was done, perhaps he would have waived his rights; but he attended the meeting, and before the price was fixed demanded the right to subscribe for 221 shares at par and offered to pay for the same immediately. It is true that after the price was fixed he did not offer to take his share at that price, but he did not acquiesce in the sale of his proportion to Blair & Company, and unless he acquiesced the sale as to him was without right. He was under no obligation to put the corporation in default by making a demand. The ordinary doctrine of demand, tender, and refusal has no application to this case. The plaintiff had made no contract. He had not promised to do anything. No duty of performance rested upon him. He had an absolute right to the new stock in proportion to his holding of the old, and he gave notice that he wanted it. It was his property, and could not be disposed of without his consent. He did not consent. He protested in due time, and the sale was made in defiance of his protest. While in connection with his protest he demanded the right to subscribe at par, that demand was entirely proper when made, because the price had not then been fixed. After the price was fixed it was the duty of the defendant to offer him his proportion at that price, for it had notice that he had not acquiesced in the proposed sale of his share, but wanted it himself. The directors were under the legal obligation to give him an opportunity to purchase at the price fixed before they could sell his property to a third party, even with the approval of a large majority of the stockholders. If he had remained silent and had made no request or protest he would have waived his rights, but after he had given notice that he wanted his part and had protested against the sale thereof, the defendant was bound to offer it to him at the price fixed by the stockholders. By selling to strangers without thus offering to sell to him, the defendant wrongfully deprived him of his property and is liable for such damages as he actually sustained.

The learned trial court, however, did not measure the damages according to law. The plaintiff was not entitled to the difference between the par value of the new stock and the market value thereof,

for the stockholders had the right to fix the price at which the stock should be sold. They fixed the price at $450 a share, and for the failure of the defendant to offer the plaintiff his share at that price we hold it liable in damages. His actual loss, therefore, is $100 per share, or the difference between $450, the price that he would have been obliged to pay had he been permitted to purchase, and the market value on the day of sale, which was $550. This conclusion requires a reversal of the judgment rendered by the Appellate Division and a modification of that rendered by the trial court.

The order appealed from should be reversed and the judgment of the trial court modified by reducing the damages from the sum of $99,450, with interest from January 30, 1902, to the sum of $22,100, with interest from that date, and by striking out the extra allowance of costs, and as thus modified the judgment of the trial court is affirmed, without costs in this court or in the Appellate Division to either party.

NOTE. — In *Archer* v. *Hesse*, 164 N.Y. App. Div. 493, the court said (p. 497): "A corporation may use its original unissued authorized capital stock for any legitimate or lawful purpose it sees fit. . . . Before making such use it is not obligated to give to existing stockholders an opportunity to purchase." But see, *contra*, *Reese* v. *Bank*, 31 Pa. 78; *Way* v. *American Grease Co.*, 60 N.J. Eq. 263, 269.

Wall v. *Utah Copper Co.*, 70 N.J. Eq. 17. Existing stockholders have a right to subscribe for bonds, convertible into stock, similar to their right to subscribe to new issues of stock.

D. To enjoin any Act which the Corporation is unauthorized to do, or which it was unauthorized to do when Plaintiff became a Stockholder.

NATUSCH *v.* IRVING.

Gow on Partnership, Appendix No. VI, p. 398. 1824.

PLAINTIFF, on behalf of himself and all others the shareholders, members, or partners of the Alliance British and Foreign Life and Fire Assurance Company, filed this bill against the president and directors, praying, *inter alia*, for an injunction to restrain them from carrying on the business of marine insurance in the name or on the account of the company, and from applying the capital of the company to any such purpose.

The case made by the bill and affidavits was, in part, as follows:

A prospectus was issued for the formation of an unincorporated company to grant fire and life insurance, with a capital of five million

pounds divided into fifty thousand shares, plaintiff subscribed for fifteen shares, paid the required deposit, insured his life in the company and paid the insurance premium. He was willing also to execute a proper deed of settlement. After the plaintiff had subscribed, etc., the majority of the company undertook to carry on the additional business of marine insurance. They prepared a deed of settlement which contained provisions for enabling the company to carry on marine insurance; and which plaintiff refused to execute. Plaintiff objected to the company's carrying on a marine insurance business. The directors informed plaintiff that, if he was dissatisfied with the course intended to be pursued, he might receive back his deposit with interest, and also have his life policy cancelled and the premium returned.

Lord Eldon, Chancellor. . . . An offer is made to the plaintiff that he may receive back his deposit with interest from the date of the payment, and he is desired to consider himself as having received notice thereof. But it is not, I apprehend, competent to any number of persons in a partnership (unless they show a contract rendering it competent to them) formed for specified purposes, if they propose to form a partnership for very different purposes, to effect that formation by calling upon some of their partners to receive their subscribed capital and interest and quit the concern; and, in effect, merely by *compelling* them to retire upon such terms, so to form a *new company.* This would, as to partnerships, be a most dangerous doctrine. Where a partnership is dissolved (even where it can be *in a sense* dissolved the instant after notice to dissolve is given, if there be no contract to the contrary), it must still continue for the purpose of winding up its affairs, of taking and settling all its accounts, and converting all the property, means and assets of the partnership existing at the time of the dissolution as beneficially as may be for the benefit of all who were partners, according to their respective shares and interests; and the other partners cannot say to him, to whom they have given an offer of his deposit and interest, *Take that, and we are a new company*, keeping the effects, means, assets, and property of the old, as the property of the new partnership.

The company will indemnify the plaintiff against loss by its transactions already had, or hereafter to be had, not for the specified purposes of the institution. But the right of a partner is to hold to the specified purposes his partners whilst the partnership continues, and not to rest upon indemnities with respect to what he has not contracted to engage in.

A dissatisfied partner may sell his shares for double what he originally gave for them. But he cannot be compelled to part with them for that reason; it may be his principal reason for keeping them, having the partnership concern carried on according to the contract.

The original contract and the loss which his partners would suffer by a dissolution, is his security that it shall be so carried on for him and them beneficially, and with augmented improvement in the value of his shares and their shares. . . .

If six persons joined in a partnership of life assurance, it seems clear that neither the majority, nor any select part of them, nor five out of the six, could engage that partnership in marine insurances, unless the contract of partnership expressly or impliedly gave that power; because if this was otherwise, an individual or individuals, by engaging in one specified concern, might be implicated in any other concern whatever, however different in its nature, against his consent.

It may be taken that the principle that would apply to the partnership of six, will apply to this partnership of 600 or 700.

NOTE. — A stockholder in a corporation has a similar right. The authorities to that effect are very numerous.

In *Offield* v. *New York, New Haven & Hartford R.R. Co.*, 203 U.S. 372, it was held that, on the facts, a statute permitting the condemnation of minority stock of a railroad corporation was constitutional.

By statute it may be provided that the objects of a corporation may be changed on the vote of the holders of a specified fraction (say, two thirds) of the stock, but that dissentient stockholders shall have a right to have their stock paid for at a valuation. See, for example, sections 40 and 43 of chapter 437 of the Acts of 1903, Massachusetts.

STEVENS *v.* RUTLAND & BURLINGTON R.R. CO.

29 Vt. 545. 1851.

AT the time the orator became a shareholder, the defendant was authorized to run a railroad between specified points. Thereafter, in 1850, the legislature authorized an extension, and this act was accepted by the directors and a majority of the shareholders. The orator sought to restrain the use of the corporate funds or credit in constructing such extension.

BENNETT, CHANCELLOR. The question is, can the orator, upon such a state of facts, claim, at the hands of the chancellor, his injunction.

It is an admitted principle, that in partnerships, and joint-stock associations, they cannot by a vote of the majority change or alter their fundamental articles of co-partnership or association, against the will of the minority, however small, unless there is an express or implied provision in the articles themselves that they may do it. It is equally well settled, that a court of chancery will, upon the applica-

tion of an individual member of a partnership, or joint-stock association, restrain, by injunction, the majority from using the funds or pledging the credit of the partnership or association in a business not warranted, and not within the scope of their fundamental articles of agreement. Courts of equity treat such proceedings by a majority, as a fraud upon the other members, which they will neither sanction nor permit. To prevent the commission of fraud, by injunction, has been one of the earliest and most appropriate heads of equity jurisdiction, as well as to relieve against it, when committed.

It was well conceded, in the argument on the defense, that if the corporation had been about to proceed to a construction of the contemplated extension without the act of 1850, it would have been a proper case for an injunction. The only question which can be open to debate is, as to what shall be the effect of the act of 1850, and a subsequent adoption of the act by the corporation, upon the individual rights of a shareholder who does not assent to its adoption? If bound by it, there is no equity in this bill. It is, and must be admitted, that the legislature has no constitutional power, unless it be reserved in the grant, to change or alter an act of incorporation without consent, and thereby cast upon the company new and additional obligations, or take from them rights guaranteed under the original charter. And indeed this the legislature have not attempted to do. It is also equally true that it is a part of the law of corporations, that they act according to the voice of the majority. But it is to be remembered, that this is not a suit in which the plaintiff seeks to protect himself in any corporate right, but in his own individual right, growing out of the fact of his having become a corporator by his subscription and its payment, to the capital stock of the company. One of an aggregate corporation may contract with the company, as well as a third person; and the rights of the individual so contracting are no more distinct and independent in the one case than in the other. The plaintiff, by his subscription, assumed to pay to the corporation, and only for the purpose specified in the charter, its amount, according to the assessments; and there was at the same time a trust created, and an implied assumption on the part of the corporation, to apply it to that object, and none other. The corporation also assumed upon themselves to account to this corporator for his share of the dividends, when this road should be completed and put in operation, and for his share of capital stock, though not *in numero*. The charter, in this case, gives to the state the right to purchase out the road of the corporation, after a given number of years, upon certain terms therein specified. The relation between each original shareholder and the corporation is the same. The obligation of the contract between the legislature and the corporation, after an acceptance of the charter, is no more sacred than that which is created between the corporation and the individual corpo-

rator. Does any one suppose the legislature could, without the consent of parties, absolve a corporator from liability on his subscription to the corporation, or modify it? and can they do the reverse of it?

It is conceded that there is a class of alterations in a charter, which the corporation may obtain and adopt, that would not so essentially change the contract as to absolve the corporator from his subscription, or give him a right to complain in a court of justice, in case he had previously paid it. Where the object of the modification or alteration of the charter is auxiliary to the original object of it, and designed to enable the corporation to carry into execution the very purpose of the original grant, with more facility and more beneficially than they otherwise could, the original corporator cannot complain; and I should apprehend it would make no difference with the rights of a corporation, in such a case, though he could show that the charter, as amended, was less beneficial to the corporators than the original one would have been. The ground upon which such amendments bind the corporator, I deem to be his own consent. When he becomes a corporator by his signing for a portion of the capital stock, he in effect agrees to the by-laws, rules, and votes of the company, and there is an implied assent, on his part, with the corporation, that they may apply for, and adopt such amendments as are within the scope, and designed to promote the execution of the original purpose; and he signs, and the corporation receive his subscription, subject to such implied contingency; and if we regard it in the nature of a license, only, it would not alter the principle. Both parties having acted upon it, it would not be countermandable.

But suppose the object of the alteration is a fundamental change in the original purpose, and designed to superadd to it something which is beyond and aside of it; does the same principle apply? Chief Justice NELSON lays down this general proposition, "that corporations can exercise no power over the corporators, beyond those conferred by the charter to which they have subscribed, except on the condition of their agreement or consent."

This is a sound proposition. The consent or assent may, however, be implied in a class of cases, as has already been stated, where the amendment is not regarded as fundamental, and can be brought within the scope of the original purpose of the association; and this is going to the very verge of the powers of the corporation. It is difficult, and would be unwise, to attempt to lay down any general rules to determine in what precise cases the assent of the corporator should be implied, and in what not. It is sufficient for the present purpose to say, that his assent cannot be implied, in a case like the present, from a majority vote. Courts may differ, and doubtless will, in regard to what alterations shall be sufficient to constitute a fundamental change. But in the present case, I think, on this point there can be but one opinion. The termini of the road, as fixed by the

charter, are Burlington, and some point on the west bank of Connecticut River, in the county of Windsor or Windham. The capital stock is one million of dollars, with a right in the corporation to increase it to an amount sufficient to complete said road, and furnish the necessary apparatus for conveyance. The supplementary act of 1850 purports to authorize the corporation, within three years, to construct and extend their railroad from the terminus in Burlington, to some point in Swanton, in the county of Franklin, a distance of about thirty miles; and the act provides that in the construction of the road, they shall have all the rights and privileges, and be subject to all the liabilities, contained in their original charter, and the acts in addition to it.

The franchise granted to this company was territorial; and an extension of the termini necessarily is an extension of the franchise. It cannot remain the same thing in substance, until it can be established that a part is equal to the whole. Besides, the company may increase the capital stock to such additional sum as shall be necessary to construct the extension.

The statute of 1850 is little less in effect, if anything, than an attempt to create in a summary manner, and by the way of reference, a new corporation, and to transfer all the old corporators to it. It is not necessary that the business should be changed in kind, to change the original purpose. If this is not a change in purpose, it would not be to extend the road in one direction to Canada line, and in the other to Massachusetts line; and there would be no limits to the control which the corporation might acquire over the individual corporators, and this, too, without their consent, except what arises from the confines of legislative authority.

The change, then, in the charter being fundamental and the corporation not being able to bind the plaintiff by a majority vote, what must be the result? If he had been sued for an assessment upon his stock, he might have claimed that he was absolved from all liability upon the acceptance of the amendment. And is not this reasonable? Shall it be said that the legislature and the corporation have power to embark this corporator in a speculation to which he has never consented? If it can be done in one case it can in another. But having paid his funds into the corporation, he has a right in chancery to compel a faithful performance of the trust by the corporation, in conformity to the original charter, and to keep them within its purview.

In the case before us, it must follow, if the plaintiff is not bound by the conjoined effect of the act of 1850, and a majority vote of the corporation, the defendants can stand on no better ground, than a voluntary association, who are about to go beyond and aside of their original articles, against the will of a minority. This, in effect, was conceded in the argument. There was nothing improper in the pas-

sage of the act of 1850, though upon the application of a portion of the directors of the company, as stated in the bill. No attempt is made by the legislature to impair the obligation of any contract between themselves and the corporation, or to cast upon the company any new and additional burthens without their consent. There was no attempt to impair any contract arising under the prior charter, between the corporation and the corporator as an individual, or disturb any vested right in either. The act is not mandatory; and there is, in fact, an implied condition annexed to it, that it is to be accepted by all whose individual and corporate interests are to be affected by it, before it shall become operative. But suppose this act had been mandatory upon the corporation and the several stockholders, to build this extension in the road within three years; would not all cry out against its palpable injustice? Suppose, instead of this, the legislature had left it optional with the corporation to accept or reject the act of 1850, and had provided, that in case of the acceptance of the amendment by the corporation, it should bind the corporators who dissented from it, or did not assent to it, and this too, in their individual rights; would there not be the same reason to cry out against it? Would it not, by its carrying a stockholder into an enterprise which he had never consented to, and changing the principles of liability between the corporation and the individual corporator from what they were under the original compact, impair and disturb vested rights under it? I have no hesitation in saying, that, in my opinion, it would be beyond the pale of the constitutional authority of the legislature.

NOTE. — It has been held that a reservation by a State of the power to alter, amend, or repeal corporate charters simply affects the relations of the corporation to the State, and not the relations of the majority of the stockholders to the minority. See *Avondale Land Co.* v. *Shook*, 170 Ala. 379; *Zabriskie* v. *Hackensack & New York R.R. Co.*, 18 N.J. Eq. 178. But there is important authority *contra*. See *Durfee* v. *Old Colony R.R. Co.*, 5 All. (Mass.) 230; *Buffalo & New York City R.R. Co.* v. *Dudley*, 14 N.Y. 336.

E. To prevent and redress an Appropriation of Corporate Assets by the Majority.

BREWER *v.* BOSTON THEATRE.

104 Mass. 378. 1870.

THIS was a bill in equity, brought by minority stockholders, against the corporation and against certain directors and other individuals, for fraudulently conspiring to lease the corporate property on a rent much below the market value and share in the profits of the lessees. The bill (as amended) alleged that individual defendants own or control a majority of the stock and control the proceedings at stockholders' meetings; also that a majority of the directors are fraudulently colluding with these defendants to continue to them the control of the corporation and its property.

WELLS, J. The defendants contend that the corporation cannot be deprived of its right to determine, in all matters not *ultra vires*, whether to impeach or to ratify transactions supposed to be prejudicial to its interests. Granting this position, it would result that in no case, as to matters *intra vires*, could a suit be maintained by individual stockholders to enforce rights or redress wrongs of the corporate body, except where the delay necessary in order to secure corporate action might defeat or endanger the attainment of appropriate relief. If, when called upon to act, the corporate body should elect to confirm the supposed wrongful transactions, or should do so indirectly by refusal to act, they would no longer be open to impeachment. If, on the other hand, it should determine to take action, it would do so in its own name and behalf; and there would be no ground of necessity for proceedings in the name of the individual corporator.

We are not prepared to say that this would not be the case in all matters to which the only objection is that they are prejudicial, or supposed to be so, to the corporate interests merely, but not illegal in themselves, and affecting all the corporators alike. Perhaps it would be so whenever the surrender of property or the release of rights, acquired by the corporation through the transactions sought to be impeached, is necessary in order to reach the proper remedy. *Great Luxembourg Railway Co.* v. *Magnay*, 25 Beav. 586. The corporation might be entitled to determine for itself exclusively whether it would retain or release property or rights thus acquired, although it thereby precluded, or rendered ineffectual, all proceedings against parties who may have made illegal or fraudulent gains out of the transactions. These questions, however, we need not at present decide.

The cases now before us involve no release of property or rights by the corporation. The alleged wrongs are not merely prejudicial to the interests of the corporation; but are such as tend to deprive one part of the corporators of their rightful share in the fruits of the common property and business, for the advantage of others of the corporators. This inequality and injustice is accomplished by means of the control over the corporate organization and management, which has been secured by the parties so benefited. By the amendments to the several bills it is alleged that such control has been exercised since the year 1866, inclusive, by Tompkins and Thayer, with the aid of the other defendants. That which is important is the fact of such control and its exercise for such purpose, rather than the means by which it has been obtained. A majority of the corporators have no right to exercise the control over the corporate management, which legitimately belongs to them, for the purpose of appropriating the corporate property or its avails or income to themselves or to any of the shareholders, to the exclusion or prejudice of the others. And if any have obtained such unfair advantage by fraud or abuse of the trust confided to them as officers or agents of the corporation, it is not in the power of a majority to ratify or condone the fraud and breach of trust, so far as it affects the rights of the others, without reasonable restitution. This proposition, if stated in reference to formal transactions, such as assessments of capital or dividends of income, would not be questioned. *Preston* v. *Grand Collier Dock Co.*, 11 Sim. 327. *Hodgkinson* v. *National Live Stock Insurance Co.*, 26 Beav. 473. But the indirect appropriation of the common property, profits or means of profit, to their own benefit, by any portion of the corporators, in fraud of their associates, is equally incapable of being authorized or ratified by the vote of a majority of the corporators, or by any act or omission of the corporate body. *Gregory* v. *Patchett*, 33 Beav. 595. *Atwool* v. *Merryweather*, Law Rep. 5 Eq. 464, note. If it were otherwise, the minority would be without means of protection or redress against inequality and injustice. They would be equally so if they could obtain redress only in the name and through the action of the corporation itself. Such acts are wrongs done primarily to the corporation; and therefore the restitution or redress is to be secured to the corporation. But in their effect and essential character they are wrongs to the individual shareholder, inflicted upon his corporate interests by means of the control over those interests secured through the corporate organization and management. He can seek his redress only through the corporation; but that does not give the corporation the right to deprive him of all redress. Any attempt to do so, whether regarded as the action of the corporation or of a majority of shareholders, would have the same voidable character as the original wrong. Officers of a corporation, dealing with it in matters of their own individual interest,

stand very differently in this respect from strangers, who have no occasion to regard any other than the corporate body. If by means of their relations to the corporate management they secure to themselves undue advantage over their associates, they cannot retain it. Such transactions are voidable, not merely for want of authority in the officers by whom they are done, but because neither the officers nor the corporation itself, by whatever majority of votes it may act, can do, assent to, or confirm them. The wrong to the individual shareholder is the same, whether committed with the concurrence or subsequent approval and adoption of his associates controlling the corporation, or without it.

In our opinion, the facts of these cases, as set forth in the several amended bills, show such abuse of authority and breaches of trust by the defendants, in misappropriating the income of the corporate property to the benefit of themselves or of some of them, as cannot be ratified or remitted by the corporation; and also such incapacity of the plaintiffs to move the corporation to take action for their redress, as entitles them, from necessity, to seek it in the form of these proceedings.

NOTE. — The authorities in *accord* are very numerous. For recent cases see *Palmbaum* v. *Magulsky*, 217 Mass. 306; *Godley* v. *Crandall Co.*, 212 N.Y. 121.

F. To compel the Corporation to assert Valid Claims, and to resist Invalid Claims.

CHAMBERS *v.* McKEE & BROS.

185 Pa. 105. 1898.

OPINION BY MR. JUSTICE WILLIAMS, March 21, 1898: —

McKee & Brothers is a partnership engaged in the manufacture of glass tableware. The Chambers & McKee Glass Co. is a corporation organized under the act of 1874 and its supplements, for the manufacture of window glass. The manufacturing plants of the partnership and the corporation are in close proximity, and are supplied with natural gas as a fuel from wells owned and operated by the corporation, under an agreement that the expense of furnishing the natural gas shall be shared, as near as may be, in proportion to the amount used at each plant. Mrs. Chambers, the plaintiff, is a large stockholder in the Chambers & McKee Glass Co., but has no interest in the partnership of McKee & Brothers.

Operations were begun in both factories some time in 1889. A difference of opinion arose as to the relative proportions of the expense

of the natural gas used and to be paid for by each. This difference was submitted to two competent experts for decision, who were to determine what sum should be paid by McKee & Brothers from the commencement of operations to December 21, 1891. If unable to agree they were empowered to select an umpire and decide by a majority. They entered upon an examination of the subject and submitted a report without selecting an umpire, in which they fixed the amount to be paid by McKee & Brothers at seventeen and seventy-two one hundredths per cent of the entire cost of the natural gas for both plants, and that to be paid by the Chambers & McKee Glass Co. at eighty-two and twenty-eight one hundredths. On December 29, 1891, the report was presented to the board of directors, and on the same day one of the arbitrators communicated to them the fact that his assent to the award had been given under the influence of an important mistake of fact, and that the award was not assented to by him. The reference to the arbitrators does not seem to have been made a rule of court or to have been drawn under any statute relating to arbitration, but to have been made by the parties with a view to securing the judgment of competent persons upon the quantity of gas used by each, and to relieve Mr. H. Sellers McKee from the very embarrassing position in which he found himself. He was the president and a large stockholder in the corporation. He was also the largest contributor to the capital of the partnership of McKee & Brothers. He was thus the head of the creditor corporation, and he was personally, as a member of his firm, the debtor. Without further meeting of the arbitrators, or other effort to investigate the alleged mistake asserted by one of them, the board of directors of the corporation, H. Sellers McKee being one of them, decided in March, 1892, to settle with McKee Brothers on the basis of the discredited award, and this was accordingly done. Four years afterwards Mrs. Chambers served the notice attached to her bill requiring the directors of the corporation to take steps to compel McKee & Brothers to pay to the corporation the money it owed for natural gas both before and after such settlement, within two weeks after such notice, and stating her intention, if this was not done, to proceed on her own behalf as a stockholder to compel such settlement. This bill was filed pursuant to the notice given by her. It is against the corporation of which she is a stockholder, and the partnership which she alleges to be its debtor, and the relief asked includes the taking of an account of the gas used by McKee & Brothers from the wells and pipe lines of the Chambers & McKee Glass Company, and the payment therefor in the proportion which the amount so used bears to the whole amount consumed by both plants. Is she entitled to have an account taken of the gas consumed by McKee & Brothers? We do not think the award is in her way. We fully agree with the learned judge of the court below that the mistake brought to the attention of the parties

by George H. Browne, one of the arbitrators, soon after the award was made, and before any action was taken upon it by either party, was of such a character as to prevent its enforcement at law or in equity. As the learned judge well said, "It was not a mere error in judgment based upon established facts, but an error in reference to the facts themselves upon which his judgment was based, and which he hastened to correct as soon as he became aware of his mistake by notifying defendant company to that effect."

After this mistake was brought to the attention of the directors, and the fact was made known to them that the relative proportion of gas consumed by McKee & Brothers was, so far at least as Mr. Browne was concerned, fixed under the influence of this mistake at much less than it should have been, it was no longer binding upon them. But corporations are governed and their business is directed by persons chosen by the stockholders for that purpose. Their action legally taken is the action of the corporation, and as between it and the persons with whom it deals, it is binding. The board of directors of the Chambers & McKee Glass Company, with full notice of the mistake of Browne, and against the protest of one or more of its members, resolved to settle the claim of the corporation they represented on the basis of the award. The amount so fixed was paid by McKee & Brothers, and received by the corporation in full settlement of the demand which had been considered by the arbitrators. If this was done in good faith by the board of directors of the corporation, every stockholder was bound by it, even though it was an error in judgment and resulted in a serious loss to the corporation. If it was not so done, but was collusive and fraudulent, it is not conclusive, but may be investigated, and upon a proper showing held to be a nullity, and an account taken for the purpose of determining the true amount of gas consumed by McKee & Brothers and the actual amount of their indebtedness to the corporation therefor. The real question, therefore, on which the plaintiff's right as a stockholder to an account depends, is the validity of the action of her agents, the board of directors. They have settled this claim. That action binds the stockholder unless it was fraudulently taken. Fraud is not presumed. The natural presumption is in favor of innocence and good faith. The plaintiff has this presumption to overcome both in her bill and by her proofs, and until she presents such a case as will justify a finding that the conduct of the board of directors in making the settlement with McKee & Brothers was fraudulent, and in bad faith toward the corporation represented by them, she has no title to the relief she seeks. It would seem from the evidence before us that the settlement complained of was not an advantageous one to the corporation or its stockholders. It is possible that personal considerations may have influenced the result; but stockholders take the risk of the business qualifications and business judgment of those

whom they may select as directors, and as a general rule they cannot be heard to complain if the action of their agents is not the most discreet and the most careful that could have been taken. But when a director betrays his trust and defrauds those whom he ought to serve with fidelity, every stockholder has a right to complain, and it is the duty of the courts to assist in relieving against the consequences of such frauds whenever it is practicable. The learned judge who heard the testimony in this case reached this conclusion from it: "It is true the plaintiff alleges that this was done (the settlement of this claim) in violation and fraud of her rights, but I can find nothing which will justify me in coming to the conclusion that the directors acted in bad faith or knowingly or intentionally disregarded the interests of the stockholders of the company." In the absence of the finding of bad faith on the part of the directors, or an intentional disregard of the interests of the corporation confided to their care, the only ground on which the relief sought could be extended was absent, and there was nothing left for the learned judge to do but dismiss the plaintiff's bill without prejudice to her right to proceed in any proper way to relieve herself from the consequences of any fraudulent acts of her agents, the directors of the Chambers & McKee Glass Company, in connection with the settlement of which she complains.

We are not disposed to allow the costs in this case to follow the result of this appeal, but will modify the decree appealed from by imposing one third of the costs in this case upon the plaintiff, one third upon the directors of the Chambers & McKee Glass Co., as individuals, and one third upon McKee & Brothers.

As so modified the decree is affirmed.

FOSS *v.* HARBOTTLE.

2 Hare, 461. 1843.

Bill in equity by Foss and Turton, shareholders in a corporation styled the Victoria Park Company, on behalf of themselves and all other shareholders, against five persons who had been directors, and also against several other persons.

The case stated in the bill was, in part, as follows:

At or after the formation of the company was agreed upon, an arrangement was fraudulently concerted between certain parties (including a majority of the directors), with the object of enabling themselves to derive a profit or personal benefit from the establishment of the company. The arrangement was, that certain of the parties should be appointed directors, and should purchase for the company certain lands owned by themselves and by other parties to the combination, at greatly increased and exorbitant prices. The

directors, accordingly, before the passing of the act, agreed to purchase certain lands at rents or prices greatly exceeding those at which the vendors had purchased the same. After the passing of the act of incorporation, the directors and their confederates proceeded to carry into execution the previously formed design of fraudulently profiting by the establishment of the company and at its expense.

WIGRAM, V.C. The Victoria Park Company is an incorporated body, and the conduct with which the Defendants are charged in this suit is an injury not to the Plaintiffs exclusively; it is an injury to the whole corporation by individuals whom the corporation entrusted with powers to be exercised only for the good of the corporation. And from the case of the *Attorney-General* v. *Wilson*, Cr. & Ph. 1 (without going further), it may be stated as undoubted law, that a bill or information by a corporation will lie to be relieved in respect of injuries which the corporation has suffered at the hands of persons standing in the situation of the directors upon this record. This bill, however, differs from that in the *Attorney-General* v. *Wilson* in this, — that instead of the corporation being formally represented as plaintiffs, the bill in this case is brought by two individual corporators, professedly on behalf of themselves and all the other members of the corporation, except those who committed the injuries complained of, — the plaintiffs assuming to themselves the right and power in that manner to sue on behalf of and represent the corporation itself.

It was not, nor could it successfully be argued, that it was a matter of course for any individual members of a corporation thus to assume to themselves the right of suing in the name of the corporation. In law, the corporation, and the aggregate members of the corporation, are not the same thing for purposes like this; and the only question can be, whether the facts alleged in this case justify a departure from the rule which *primâ facie* would require that the corporation should sue in its own name and in its corporate character, or in the name of some one whom the law has appointed to be its representative.

The first objection taken in the argument for the Defendants was, that the individual members of the corporation cannot in any case sue in the form in which this bill is framed. During the argument I intimated an opinion, to which, upon further consideration, I fully adhere, that the rule was much too broadly stated on the part of the Defendants. I think there are cases in which a suit might properly be so framed. Corporations like this, of a private nature, are in truth little more than private partnerships; and in cases which may easily be suggested, it would be too much to hold, that a society of private persons associated together in undertakings, which, though certainly beneficial to the public, are nevertheless matters of private property, are to be deprived of their civil rights, *inter se*, because, in order to make their common objects more attainable, the crown or the legis-

lature may have conferred upon them the benefit of a corporate character. If a case should arise of injury to a corporation by some of its members, for which no adequate remedy remained, except that of a suit by individual corporators in their private characters, and asking in such character the protection of those rights to which in their corporate character they were entitled, I cannot but think that the principle so forcibly laid down by Lord COTTENHAM in *Wallworth* v. *Holt*, 4 Myl. & Cr. 635; see also 17 Ves. 320, per Lord ELDON, and other cases, would apply, and the claims of justice would be found superior to any difficulties arising out of technical rules respecting the mode in which corporations are required to sue.

But, on the other hand, it must not be without reasons of a very urgent character that established rules of law and practice are to be departed from, — rules, which, though in a sense technical, are founded on general principles of justice and convenience; and the question is, whether a case is stated in this bill, entitling the Plaintiffs to sue in their private characters. [By the constitution of the company] the directors are made the governing body, subject to the superior control of the proprietors assembled in general meetings; and, as I understand the act, the proprietors so assembled have power, due notice being given of the purposes of the meeting, to originate proceedings for any purpose within the scope of the company's powers, as well as to control the directors in any acts which they may have originated. There may possibly be some exceptions to this proposition, but such is the general effect of the provisions of the statute. . . . The corporation might elect to adopt those transactions.

Whilst the supreme governing body, the proprietors at a special general meeting assembled, retain the power of exercising the functions conferred upon them by the act of incorporation, it cannot be competent to individual corporators to sue in the manner proposed by the Plaintiffs on the present record. This in effect purports to be a suit by *cestui que* trusts, complaining of a fraud committed or alleged to have been committed by persons in a fiduciary character. The complaint is, that those trustees have sold lands to themselves, ostensibly for the benefit of the *cestui que* trusts. The proposition I have advanced is, that although the act should prove to be voidable, the *cestui que* trusts may elect to confirm it. Now, who are the *cestui que* trusts in this case? The corporation, in a sense, is undoubtedly the *cestui que* trust; but the majority of the proprietors at a special general meeting assembled, independently of any general rules of law upon the subject, by the very terms of the incorporation in the present case, has power to bind the whole body, and every individual corporator must be taken to have come into the corporation upon the terms of being liable to be so bound. How then can this Court act in a suit constituted as this is, if it is to be assumed, for the pur-

poses of the argument, that the powers of the body of the proprietors are still in existence, and may lawfully be exercised for a purpose like that I have suggested? Whilst the Court may be declaring the acts complained of to be void at the suit of the present Plaintiffs, who in fact may be the only proprietors who disapprove of them, the governing body of proprietors may defeat the decree by lawfully resolving upon the confirmation of the very acts which are the subject of the suit. The very fact that the governing body of proprietors assembled at the special general meeting may so bind even a reluctant minority, is decisive to shew that the frame of this suit cannot be sustained whilst that body retains its functions. In order then that this suit may be sustained, it must be shewn either that there is no such power as I have supposed remaining in the proprietors, or, at least, that all means have been resorted to and found ineffectual to set that body in motion: this latter point is nowhere suggested in the bill.

NOTE. — In *Burland* v. *Earle*, [1902] A.C. 83, Lord DAVEY said (p. 93): "It is an elementary principle of the law relating to joint-stock companies that the Court will not interfere with the internal management of companies acting within their powers, and in fact has no jurisdiction to do so. Again, it is clear law that in order to redress a wrong done to the company or to recover moneys or damages alleged to be due to the company, the action should *primâ facie* be brought by the company itself. These cardinal principles are laid down in the well-known cases of *Foss* v. *Harbottle*, (1843) 2 Hare, 461, and *Mozley* v. *Alston*, (1847) 1 Ph. 790, and in numerous later cases which it is unnecessary to cite. But an exception is made to the second rule, where the persons against whom the relief is sought themselves hold and control the majority of the shares in the company, and will not permit an action to be brought in the name of the company. In that case the Courts allow the shareholders complaining to bring an action in their own names. This, however, is mere matter of procedure in order to give a remedy for a wrong which would otherwise escape redress, and it is obvious that in such an action the plaintiffs cannot have a larger right to relief than the company itself would have if it were plaintiff, and cannot complain of acts which are valid if done with the approval of the majority of the shareholders, or are capable of being confirmed by the majority. The cases in which the minority can maintain such an action are, therefore, confined to those in which the acts complained of are of a fraudulent character or beyond the powers of the company. A familiar example is where the majority are endeavoring directly or indirectly to appropriate to themselves money, property, or advantages which belong to the company, or in which the other shareholders are entitled to participate, as was alleged in the case of *Menier* v. *Hooper's Telegraph Works*, (1874) L.R. 9 Ch.

350." See also *Dominion Cotton Mills Co., Ltd.*, v. *Amyot*, [1912] A.C. 546.

See *Pollitz* v. *Wabash R.R. Co.*, 207 N.Y. 113.

GROEL *v.* UNITED ELECTRIC COMPANY.

70 N.J. Eq. 616. 1905.

Garrison, V.C. From the above statement of the contents of the pleadings, it will appear that the following excerpts from the brief of counsel for the defendants correctly define the issue: —

"The bill in this case was filed to compel the United Gas Improvement Company to account to the United Electric Company of New Jersey for the profits alleged to have been made by the gas company secretly in the promotion of the electric company. The gas company and the electric company are named in the bill as defendants, but it is obvious that the gas company is the only defendant against which a decree can be made. The electric company was made a party as required by the practice in cases where a stockholder is permitted to bring suit to enforce a claim which the company should have prosecuted voluntarily. . . .

"The electric company filed the plea for the reasons stated therein, and in the schedules thereto annexed, and insists that as it thinks the bringing of such a suit is inexpedient, all things considered, it has a right to prohibit any stockholder from doing so who differs with the judgment of its board of directors on that subject."

A stockholder sets up that approximately $20,000,000 of stock as a secret profit was made by the promoter out of the incorporation of the company of which he is a stockholder. He sues the promoter and joins his corporation, which has refused to bring the suit, to recover the $20,000,000 of stock. His corporation responds that it deems it inexpedient to bring the suit. The single point is whether a board of directors may prohibit a stockholder from bringing a suit in behalf of the corporation to recover moneys secretly made by a promoter out of the incorporation of the company, if, in the judgment of the board, it is inexpedient to bring such a suit.

There can be no question that promoters are liable to the corporation for profits secretly made by them in its promotion, and that such liability arises in cases where future allottees of stock are concerned.

There can be likewise no question that where the corporation refuses to bring a suit stockholders may sue in its behalf, joining it as a defendant.

It is true that courts will not interfere, as a rule, with the management of corporations by the directors thereof when they are acting within their powers and in good faith. But whether the directors

are acting in good faith and as honest, diligent trustees, or not, will be inquired into by the courts at the instance of stockholders in cases like the present.

"A stockholder has no standing in the court to prosecute such an action except on the refusal of the directors, either actual or presumptive, to prosecute. But such refusal of the directors to prosecute must be an unjustifiable refusal." *Willoughby* v. *Chicago Junction Railways Co.*, 50 N.J. Eq. (5 Dick.) at p. 667 (Vice-Chancellor Green, 1892).

In the case of *Kessler* v. *Ensley Company*, 129 Fed. Rep. 397 (at p. 400), the court said: "Of necessity, then, the governing body, in every *intra vires* matter, has a discretion to determine what action to take on the stockholder's request to sue, and when the stockholder comes into court the first question it must determine is whether that discretion has been properly or improperly exercised."

The Supreme Court of the United States reviewed the previous decisions concerning this matter, and announced the true rule in the case of *Corbus* v. *Alaska Treadwell Gold Mining Co.*, 187 U.S. 455; 47 L. Ed. 256: —

"This court will examine the bill in its entirety and determine whether, under all the circumstances, the plaintiff has made such a showing of wrong on the part of the corporation or its officers and injury to himself as will justify the suit." And it likewise quoted with approval the following language: "The circumstances of each case must determine the jurisdiction of a court of equity to give the relief sought."

Viewing this case in the light of the principles which must be applied to it, and of the authorities which have been quoted, can it be said that the directors have shown justification for refusing to bring a suit to recover approximately $20,000,000 of stock improperly obtained by a promoter?

Would it not clearly be held by any court to be a breach of trust for directors to neglect or refuse to recover, or seek to recover, such an amount of stock improperly obtained from it by a promoter?

It is perfectly clear that if the complainant sets forth a good cause of action, and there is a right in the corporation to recover $20,000,000 of stock from the promoter, it is a clear breach of trust on the part of the directors not to proceed to recover the same.

For them to reply that it is by them deemed inexpedient to do so, is only to emphasize the breach of trust they are committing by not doing so.

I am aware that counsel for the defendant argues that their unwillingness to bring the suit, and that which in their judgment makes it inexpedient to bring the suit, proceeds from their view that the suit cannot succeed. I think I have sufficiently expressed my idea that this issue is not present before me for determination. If, on the

face of the bill, it appears that the complainant cannot succeed, then demurrer is the proper remedy. If the bill, however, does set up a good cause of action, then, as I have already pointed out, the plea does not set up any other facts excepting the passage by the directors of a resolution refusing to bring the suit because in their judgment inexpedient.

There was much argument before me upon issues which I do not find in the case, the defendant contending that it had sufficiently shown that the suit ought not to be brought because it could not be successful, and the complainant replying that the statements in the report of the committee, as incorporated into the plea, show clearly that there is a cause of action, and that the defendant has not, on the merits, shown any reason why the suit should not be brought. I do not stop to consider these questions for the reasons given. I find that the complainant sets out a cause of action, and that the defendant replies by plea that it deems it inexpedient to bring a suit for this cause of action, and that the complainant, its stockholder, is precluded by reason of this fact.

I find that the principle to be applied is that the stockholder may appeal to the discretion of the court in this respect, and upon considering the whole case, I do not think it appears that the defendant was justified in refusing to bring the suit, with the result that the complainant may proceed, and the plea must be overruled.

NOTE. — See *Hill* v. *Murphy*, 212 Mass. 1.

DODGE *v.* WOOLSEY.

18 How. (U.S.) 331. 1855.

THIS is a suit in equity by John M. Woolsey, to enjoin the collection of a tax, assessed by the State of Ohio, on the Commercial Branch Bank of Cleveland, a branch of the State Bank of Ohio. The defendants are Dodge, the tax collector, the directors of the bank, and the bank itself.

Woolsey avers that he is a citizen of Connecticut, that he is the owner of thirty shares in the Branch Bank of Cleveland, that Dodge and the other defendants are all citizens of Ohio, and that the Commercial Branch Bank is a corporation, made such by an act of the legislature of Ohio. He alleges that, by the act of incorporation, the Bank was to pay semiannually to the State a certain percentage on its profits, which was to be in lieu of all taxes to which the corporation, or the stockholders on account of their stock, would otherwise be subject. He further alleges that subsequent changes were made by the constitution and statutes of Ohio, undertaking to tax the

Bank at a different and more burdensome rate. He asks the court to enjoin Dodge from collecting by distress a tax which has been assessed against the Bank under this law; contending that the subsequent statute and assessment are in violation of the clause in the U.S. Constitution, which prohibits States from passing laws impairing the obligation of contracts. He finally declares that, as a stockholder of the Bank, he had requested the directors to take measures, by suit or otherwise, to assert the franchises of the Bank against the collection of what he believes to be an unconstitutional tax, and that they had refused to do so.

Dodge filed an answer, in which he denied that Woolsey had made any application to the directors to prevent the collection of the tax. But it was agreed by the counsel that such an application had been made; and that the directors replied that, though concurring in the view that the tax was illegal, yet, in consideration of the many obstacles in the way of testing the law in the courts of the State, they could not consent to take the action which they were asked to take.

WAYNE, J. Upon the foregoing pleadings and admission, the circuit court rendered a final decree for the complainant, perpetually enjoining the treasurer against the collection of the tax, under the act of the 13th February, 1852, and subjecting the defendant, Dodge, to the payment of the costs of the suit. From that decision the defendant, Dodge, has appealed to this court.

His counsel have relied upon the following points to sustain the appeal: —

1. The complainant does not show himself to be entitled to relief in a court of chancery, because the charter of the bank provides that its affairs shall be managed by a board of directors, and that they are not amenable to the stockholders for an error of judgment merely. And that in order to make them so, it should have been averred that they were in collusion with the tax collector in their refusal to take legal steps to test the validity of the tax.

2. It was urged that this suit had been improperly brought in the circuit court of the United States for the district of Ohio, because it is a contrivance to create a jurisdiction, where none fairly exists, by substituting an individual stockholder in place of the Commercial Bank as complainant, and making the directors defendants; the stockholder being made complainant, because he is a citizen of the State of Connecticut, and the directors being made defendants to give countenance to his suit. . . .

We will consider the points in their order. The first comprehends two propositions, namely: that courts of equity have no jurisdiction over corporations, as such, at the suit of a stockholder for violations of charters, and none for the errors of judgment of those who manage their business ordinarily.

There has been a conflict of judicial authority in both. Still, it has

been found necessary, for prevention of injuries for which common-law courts were inadequate, to entertain in equity such a jurisdiction in the progressive development of the powers and effects of private corporations upon all the business and interests of society.

It is now no longer doubted, either in England or the United States, that courts of equity, in both, have a jurisdiction over corporations, at the instance of one or more of their members; to apply preventive remedies by injunction, to restrain those who administer them from doing acts which would amount to a violation of charters, or to prevent any misapplication of their capitals or profits, which might result in lessening the dividends of stockholders, or the value of their shares, as either may be protected by the franchises of a corporation, if the acts intended to be done create what is in the law denominated a breach of trust. And the jurisdiction extends to inquire into, and to enjoin, as the case may require that to be done, any proceedings by individuals, in whatever character they may profess to act, if the subject of complaint is an imputed violation of a corporate franchise, or the denial of a right growing out of it, for which there is not an adequate remedy at law. 2 Russ. & Mylne Ch. R., *Cunliffe* v. *Manchester and Bolton Canal Company*, 480, *n.*; *Ware* v. *Grand Junction Water Company*, 2 Russ. & Mylne, 470; *Bagshaw* v. *Eastern Counties Railway Company*, 7 Hare Ch. R. 114; Angell & Ames, 4th ed. 424, and the other cases there cited.

It was ruled in the case of *Cunliffe* v. *The Manchester and Bolton Canal Company*, 2 Russ. & Mylne Ch. R. 481, that where the legal remedy against a corporation is inadequate, a court of equity will interfere, and that there were cases in which a bill in equity will lie against a corporation by one of its members. "It is a breach of trust towards a shareholder in a joint stock incorporated company, established for certain definite purposes prescribed by its charter, if the funds or credit of the company are, without his consent, diverted from such purpose, though the misapplication be sanctioned by the votes of a majority; and, therefore, he may file a bill in equity against the company in his own behalf to restrain the company by injunction from any such diversion or misapplication." In the case of *Ware* v. *Grand Junction Water Company*, 2 Russell & Mylne, a bill filed by a member of the company against it, Lord BROUGHAM said: "It is said this is an attempt on the part of the company to do acts which they are not empowered to do by the acts of parliament," meaning the charter of the company; "so far I restrain them by injunction." "Indeed, an investment in the stock of a corporation must, by every one, be considered a wild speculation, if it exposed the owners of the stock to all sorts of risk in support of plausible projects not set forth and authorized by the act of incorporation, and which may possibly lead to extraordinary losses." The same jurisdiction was invoked and applied in the case of *Bagshaw* v. *The Eastern*

Counties Railway Company; so, also, in *Coleman* v. *the same company,* 10 Beavan's Ch. Reports, 1. It appeared in that case that the directors of the company, for the purpose of increasing their traffic, proposed to guarantee certain profits, and to secure the capital of an intended steam packet company, which was to act in connection with the railway. It was held, such a transaction was not within the scope of their powers, and they were restrained by injunction. And in the second place, that in such a case one of the shareholders in the railway company was entitled to sue in behalf of himself and all the other shareholders, except the directors, who were defendants, although some of the shareholders had taken shares in the steam packet company. It was contended in this case that the corporation might pledge, without limit, the funds of the company for the encouragement of other transactions, however various and extensive, provided the object of that liability was to increase the traffic upon the railway, and thereby increase the traffic to the shareholders. But the master of the rolls, Lord LANGDALE, said, "there was no authority for anything of that kind."

But further, it is not only illegal for a corporation to apply its capital to objects not contemplated by its charter, but also to apply its profits. And therefore a shareholder may maintain a bill in equity against the directors and compel the company to refund any of the profits thus improperly applied. It is an improper application for a railway company to invest the profits of the company in the purchase of shares in another company. . . .

The result of the cases is well stated in Angell & Ames, paragraphs 391, 393. "In cases where the legal remedy against a corporation is inadequate, a court of equity will interfere, is well settled, and there are cases in which a bill in equity will lie against a corporation by one of its members." "Though the result of the authorities clearly is, that in a corporation, when acting within the scope of and in obedience to the provisions of its constitution, the will of the majority, duly expressed at a legally constituted meeting, must govern; yet beyond the limits of the act of incorporation, the will of the majority cannot make an act valid; and the powers of a court of equity may be put in motion at the instance of a single shareholder, if he can show that the corporation are employing their statutory powers for the accomplishment of purposes not within the scope of their institution. Yet it is to be observed, that there is an important distinction between this class of cases and those in which there is no breach of trust, but only error and misapprehension, or simple negligence on the part of the directors." . . .

We have then the rule and its limitation. It is contended that this case is within the limitation; or that the directors of the Commercial Bank of Cleveland, in their action in respect to the tax assessed upon it, under the act of April 18, 1852, and in their refusal to take proper

measures for testing its validity, have committed an "error of judgment merely." . . .

Now, in our view, the refusal upon the part of the directors, by their own showing, partakes more of disregard of duty, than of an error of judgment. It was a non-performance of a confessed official obligation, amounting to what the law considers a breach of trust, though it may not involve intentional moral delinquency. It was a mistake, it is true, of what their duty required from them, according to their own sense of it, but, being a duty by their own confession, their refusal was an act outside of the obligation which the charter imposed upon them to protect what they conscientiously believed to be the franchises of the bank. A sense of duty and conduct contrary to it, is not "an error of judgment merely," and cannot be so called in any case. It amounted to an illegal application of the profits due to the stockholders of the bank, into which a court of equity will inquire to prevent its being made.

Thinking, as we do, that the action of the board of directors was not "an error of judgment merely," but a breach of duty, it is our opinion that they were properly made parties to the bill, and that the jurisdiction of a court of equity reaches such a case to give such a remedy as its circumstances may require. This conclusion makes it unnecessary for us to notice further the point made by the counsel that the suit should have been brought in the name of the corporation, in support of which they cited the case of the *Bank of the United States* v. *Osborn.* The obvious difference between this case and that is, that the Bank of the United States brought a bill in the circuit court of the United States for the district of Ohio, to resist a tax assessed under an act of that State, and executed by its auditor, and here the directors of the Commercial Bank of Cleveland, by refusing to do what they had declared it to be their duty to do, have forced one of its corporators, in self-defense, to sue. If the directors had done so in a state court of Ohio, and put their case upon the unconstitutionality of the tax act, because it impaired the obligation of a contract, and had the decision been against such claim, the judgment of the state court could have been re-examined, in that particular, in the supreme court of the United States, under the same authority or jusridiction by which it reversed the judgment of the supreme court of Ohio, in the case of the *Piqua Branch of the State Bank of Ohio* v. *Jacob Knoop, treasurer of Miami County*, 16 How. 369.

Decree of Circuit Court affirmed.

Catron, J., Daniel, J., and Campbell, J., dissented.

G. Procedure in a Suit by Stockholder to assert a Corporate Right.

DAVENPORT *v.* DOWS.

18 Wall. (U.S.) 626. 1873.

Dows, a citizen of New York, in behalf of himself and all other non-resident citizens of Iowa, who were stockholders in the Chicago, Rock Island, and Pacific Railroad Company, filed a bill in the court below against the city of Davenport, and its marshal, to arrest the collection of a tax, alleged to be illegal, levied by the said city for general revenue purposes, on the property of the company within its limits. The bill assigned as a reason for its being filed by Dows, a stockholder in the company, instead of by the company itself, that the company neglected and refused to take action on the subject. A demurrer was interposed to the bill, which was overruled, and on the defendants refusing to answer over, the circuit court ordered that the collection of the tax be perpetually enjoined. From this, its action, the defendants appealed, insisting that the circuit court erred in overruling the demurrer, for three reasons:

First. Because the railroad company was not made a party to the bill. . . .

Mr. Justice Wayne. That a stockholder may bring a suit when a corporation refuses is settled in *Dodge* v. *Woolsey*, 18 Howard, 340, but such a suit can only be maintained on the ground that the rights of the corporation are involved. These rights the individual shareholder is allowed to assert in behalf of himself and associates, because the directors of the corporation decline to take the proper steps to assert them. Manifestly the proceedings for this purpose should be so conducted that any decree which shall be made on the merits shall conclude the corporation. This can only be done by making the corporation a party defendant. The relief asked is on behalf of the corporation, not the individual shareholder, and if it be granted the complainant derives only an incidental benefit from it. It would be wrong, in case the shareholder were unsuccessful, to allow the corporation to renew the litigation in another suit, involving precisely the same subject-matter. To avoid such a result, a court of equity will not take cognizance of a bill brought to settle a question in which the corporation is the essential party in interest, unless it is made a party to the litigation.

DUNPHY v. TRAVELLER NEWSPAPER ASSOCIATION.

146 Mass. 495. 1888.

KNOWLTON, J. . . . The only exception to the rule that a stockholder must apply to the directors, and also if need be to the corporation, for redress of a wrong done it, before he can sue in a court of equity, for himself and in behalf of other stockholders, is when it appears that such application would be unavailing to protect his rights. *Brewer* v. *Boston Theatre*, 104 Mass. 378; *Allen* v. *Wilson*, 28 Fed. Rep. 667; *Hawes* v. *Oakland*, 104 U.S. 450; *Detroit* v. *Dean*, 106 U.S. 537; *Dimpfell* v. *Ohio & Mississippi Railway*, 110 U.S. 209; *Foss* v. *Harbottle*, 2 Hare, 461. That may happen when the directors themselves are the wrongdoers, or are in fraudulent combination with them, or when the corporation is controlled by them, or when it is necessary that action should be taken too speedily to leave time for a corporate meeting of stockholders.

In the case at bar there is an averment that Roland Worthington, the alleged wrongdoer, has for a long time controlled a majority of the stock, and has elected such persons directors as he chose. That states a sufficient reason for not applying to the corporation, at a meeting of its members, for action to redress its wrongs. But it is not alleged that the plaintiff ever attempted to move the directors in the interest of the corporation in the matters complained of, or that any good reason existed for his failure so to do. It does not even appear who or how many the directors are. It is said that the defendants Roland Worthington and Roland Worthington the younger are directors, but no others are named. The law provides that there shall be at least three, and it is to be presumed that there are others besides these defendants. Rev. Sts. c. 38, § 3; Pub. Sts. c. 106, § 25. There is no allegation of fraud, or of wrongful combination with Roland Worthington, or of other misconduct, on the part of any of them. And it cannot be presumed, in the absence of such averments, that they would refuse to do their duty if their attention were called to it.

In *Brewer* v. *Boston Theatre*, *ubi supra*, — a much stronger case for the plaintiff than this, — an allegation was in these words: "A majority of the present board of directors of said defendant corporation are acting in the interest of, and are under the control of, Tompkins and Thayer," the authors of the alleged frauds; and it was held that this allegation did not set forth a sufficient reason for bringing a suit without first requesting the directors to do it.

CONTINENTAL SECURITIES CO. *v.* BELMONT.

206 N.Y. 7. 1912.

Chase, J. This is a representative action derived from the Interborough Rapid Transit Company. It is brought in behalf of the plaintiffs and all others similarly interested, as stockholders of said company, against the directors of said company and said company to require said individual defendants to account to said company for fifteen thousand shares of its capital stock, alleged to have been issued fraudulently and illegally, and without any valid or adequate consideration therefor, but upon an alleged consideration that was a pretense and subterfuge and intended to cover a gift or bonus to the defendants Belmont and Luttgen, and their nominees, and also to require said individual defendants to account for the dividends which have been paid on said stock. It is alleged that by reason of the facts set forth in the complaint the defendant corporation has suffered damage to an amount exceeding $4,500,000.

It is conceded that an action in equity cannot be maintained by the plaintiffs as individual stockholders for themselves and all others similarly interested unless it is necessary because of the neglect and refusal of the corporate body to act.

It is necessary, therefore, in an action by the plaintiffs to set forth two things, *first,* a cause of action in favor of the corporation with the same detail of facts as would be proper in case the corporation itself had brought the action; *second,* the facts which entitle the plaintiff to maintain the action in place of the corporation. *Kavanaugh* v. *Commonwealth Trust Co.*, 181 N.Y. 121; *O'Connor* v. *Virginia Passenger & Power Co.*, 184 N.Y. 46.

It is not seriously contended that the complaint does not state a good cause of action in favor of the defendant corporation. It is insisted by the defendants that it was necessary for the plaintiffs in addition to alleging a demand upon the defendant corporation and its board of directors to bring the action and their neglect and refusal to do so, to allege that they had given notice of the alleged fraud to the body of stockholders of the defendant corporation and had demanded of said stockholders that some action be taken by them to redress the wrong, and that such body of stockholders had neglected and refused to take any action relating thereto. The cause of action belongs to the corporate body and not to the plaintiffs and other stockholders individually, nor to the body of stockholders collectively.

The board of directors represents the corporate body. It is provided by statute in this state that the affairs of every corporation shall be managed by its board of directors. General Corporation Law, § 34. The directors are not ordinary agents in the immediate

control of the stockholders. The directors hold their office charged with the duty to act for the corporation according to their best judgment, and in so doing they cannot be controlled in the reasonable exercise and performance of such duty. The corporation is the owner of the property, but the directors in the performance of their duty possess it and act in every way as if they owned it. *People ex rel. Manice* v. *Powell*, 201 N.Y. 194. They are trustees clothed with the power of controlling the property and managing the affairs of a corporation without let or hindrance. As to third persons they are its agents, but as to the corporation itself, equity holds them liable as trustees. 2 Pomeroy's Equity Jurisprudence, §§ 1061, 1073, 1088, 1097; *People ex rel. Manice* v. *Powell, supra.*

The claim of the appellants that the body of stockholders has some immediate or direct authority to act for the corporation or to control the board of directors in the matters set forth in the complaint is based upon an erroneous conception of the duties and powers of the body of stockholders in this state. As a general rule stockholders cannot act in relation to the ordinary business of a corporation. The body of stockholders have certain authority conferred by statute which must be exercised to enable the corporation to act in specific cases, but except for certain authority conferred by statute, which is mainly permissive or confirmatory, such as consenting to the mortgage, lease or sale of real property of the corporation, they have no express power given by statute. They are not by any statute in this state given general power of initiative in corporate affairs. Any action by them relating to the details of the corporate business is necessarily in the form of an assent, request or recommendation. Recommendations by a body of stockholders can only be enforced through the board of directors, and indirectly by the authority of the stockholders to change the personnel of the directors at a meeting for the election of directors. Such action may or may not result in securing adequate corporate action with reference to illegal or fraudulent acts. For reasons wholly apart from the matter in dispute the stockholders may not desire to change a majority of the persons comprising its board of directors. Some of the reasons why the power vested in stockholders to elect directors is inadequate as a remedy for specific fraudulent acts are stated by Cook in his work on Stock and Stockholders, § 740, in which he says: "There has been considerable discussion as to whether the stockholder in addition to his request to the corporate officers to institute the suit, should not also be required to attempt to induce the stockholders in meeting assembled to take action by directing the directors to bring suit, or by refusing to re-elect them at the next election. The facts, however, that the stockholders in meeting assembled cannot control the discretion of the directors in bringing such a suit; that the remedy of refusing to re-elect them involves delay, and the assumption

that a minority of the stockholders can by the election control such a suit; that irreparable injury or the vesting of great financial interests may occur in the meantime; and that laches may arise as a bar to the stockholder's suit, have settled the rule that the stockholder's request to the corporate directors to institute the suit is sufficient. He need not also apply to a stockholders' meeting." Although it is said that the authority of stockholders in the management of business corporations is exhausted when they elect the directors (Thompson on Corporations [2d ed.], § 1178) nevertheless it is generally recognized that certain acts of boards of directors that are legal, but voidable, can be ratified and confirmed by a majority of the body of stockholders as the ultimate parties in interest and thus make them binding upon the corporation. Morawetz on Corporations (2d ed.), §§ 625, 626. Such recognized authority in stockholders to ratify and confirm the acts of boards of directors is confined to acts voidable by reason of irregularities in the make up of the board or otherwise or by reason of the directors or some of them being personally interested in the subject-matter of the contract or act, or for some other similar reason which makes the action of the directors voidable. No such authority exists in case of an act of the board of directors which is prohibited by law or which is against public policy. *Kent* v. *Quicksilver Mining Co.*, 78 N.Y. 159. In any case where action is taken by stockholders confirming and ratifying a fraud and misapplication of the funds of the corporation by the directors or others the action is binding only by way of estoppel upon such stockholders as vote in favor of such approval. Morawetz on Corporations (2d ed.), § 625. The distinction between acts that can and those that cannot be confirmed and ratified is shown in the report of two frequently cited English decisions, namely, *Foss* v. *Harbottle*, 2 Hare, 461, and *Bagshaw* v. *Eastern Union R'way Co.*, 7 Hare, 114. The former of these cases was limited to the approval of a legal but voidable act. In the *Bagshaw* case where the directors of a corporation had misapplied or were about to misapply certain moneys of the corporation, the court say: "No majority of the shareholders, however large, could sanction the misapplication of this portion of the capital. A single dissenting voice would frustrate the wishes of the majority. Indeed, in strictness, even unanimity would not make the act lawful. This appears to me to take it out of the case of *Foss* v. *Harbottle*, to which I was referred. That case does not, I apprehend, upon this point, go further than this: That if the act, though it be the act of the directors only, be one which a general meeting of the company could sanction, a bill by some of the shareholders on behalf of themselves and others, to impeach that act, cannot be sustained, because a general meeting of the company might immediately confirm and give validity to the act of which the bill complains."

It is the governing body or bodies of a corporation with power to

enforce a remedy to whom complaining stockholders must go with their demand for relief. The governing body of corporations in this state, as we have seen, is the board of directors. A complaining stockholder must go to such board for relief before he can bring an action, unless it clearly appears by the complaint that such application is useless. If the subject-matter of the stockholder's complaint is for any reason within the immediate control, direction or power of confirmation of the body of stockholders, it should be brought to the attention of such stockholders for action, before an action is commenced by a stockholder unless it clearly appears by the complaint that such application is useless.

The decision reported in *Hawes* v. *Oakland*, 104 U.S. 450, and other similar decisions in the Federal and state courts are not in conflict with the decision about to be rendered herein. In such cases, as in this case, it is asserted that an application to the body of stockholders is unnecessary when it is unreasonable to require it. If the body of stockholders has no adequate power or authority to remedy the wrong asserted by the individual stockholders it is unreasonable and unnecessary to require an application to it to redress the wrong before bringing a representative action. See opinion of CARR, J., in the Appellate Division herein, 150 App. Div. 298. See, also, *Delaware & H. Co.* v. *Albany & S. R.R. Co.*, 213 U.S. 435.

NOTE. — See *Baillie* v. *Oriental Telephone Co.*, [1915] 1 Ch. 503.

WATHEN *v.* JACKSON OIL CO.

235 U.S. 635. 1915.

MR. JUSTICE HUGHES delivered the opinion of the court.

The appellant brought this suit in the District Court to restrain the Jackson Oil & Refining Company, its manager and officers, from complying with a statute of Mississippi prohibiting employment in described occupations for more than ten hours a day, except in cases of emergency or public necessity (Chapter 157, Laws of Mississippi, 1912, p. 165) and to enjoin the other defendants (certain public officers) from enforcing its provisions as against that company.

It was alleged in the bill, in substance, that the defendant corporation was engaged in operating a cotton seed oil mill of the value of $100,000; that the complainant owned five hundred and two shares of its stock of the par value of one hundred dollars each and of the actual value of $60,000; that the business required that the mill should be operated continuously, both day and night, two shifts of laborers being employed; that the employment was under wholesome conditions, without any detriment to the physical, mental and moral well-

being of those employed; that the statute, if enforced, would work a deprivation of liberty of contract and of property, and an arbitrary discrimination, contrary to the Fourteenth Amendment; that compliance with the statute would involve greatly increased cost of operation and render the corporation insolvent and its property valueless, to the complainant's injury; that the statute had been sustained by the Supreme Court of Mississippi in a suit against another manufacturing company; that, although the officers of the defendant corporation desired to disobey the statute, they were complying therewith being constrained to obedience through fear of the enormous penalties imposed; and that these penalties were so severe that no owner or operator in the position of the defendant corporation could invoke the jurisdiction of a court to test the validity of the statute, except at the risk of confiscation.

Those defendants who were public officers demurred to the bill upon the grounds (among others) that the complainant as a stockholder of the corporation had no right to sue; that the bill could not be maintained to restrain the enforcement of the criminal law of the State; and that the statute was constitutional.

An application for a preliminary injunction was heard on the bill and demurrer and was denied, and from the order entered to this effect the complainant appeals to this court. Judicial Code, § 266.

The objection urged below, and repeated here, that the complainant has failed to show any right to maintain this suit must be sustained. The right of action to restrain the enforcement of the statute as an unconstitutional deprivation of the liberty and property of the corporation was a right existing in the corporation itself, and a stockholder was not entitled to sue without showing to the satisfaction of the court that he had exhausted the means within his reach to obtain action by the corporation in conformity with his wishes. *Hawes* v. *Oakland*, 104 U.S. 450, 460, 461; *Detroit* v. *Dean*, 106 U.S. 537, 541, 542; *Quincy* v. *Steel*, 120 U.S. 241, 248; *Doctor* v. *Harrington*, 196 U.S. 579, 588. The former equity rule (Rule 94, 210 U.S. 541) provided not only that the bill must allege that the suit was "not a collusive one to confer upon a court of the United States jurisdiction of a case of which it would not otherwise have cognizance," but that the bill "must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders, and the cause of his failure to obtain such action." The present rule (Rule 27, 226 U.S. Appx., p. 8) adds to this provision the words, — "or the reasons for not making such effort"; and these reasons, of course, must be adequate. The rule embraces those cases where the wrong to the corporation arises from unconstitutional legislation. *Corbus* v. *Alaska Gold Mining Co.*, 187 U.S. 455; *Davis & Farnum Mfg. Co.* v. *Los Angeles*, 189 U.S. 207, 220; *Ex parte Young*, 209 U.S. 123, 143.

Here, while it is averred that the suit is not a collusive one in order to confer a jurisdiction which would not otherwise exist, there is no allegation that the complainant has made any request that the corporation should bring the suit to prevent the alleged invasion of its rights; nor does it appear that, by reason of antagonistic control of the corporation, such a request would be futile. Although apparently the holder of a majority of its stock, the complainant does not show any effort whatever to induce the corporation to sue. He contents himself with asserting in effect that, though the directors and officers do not wish to comply with the statute, they will do so through fear of its penalties. But this reason is palpably inadequate inasmuch as the corporation itself would be entitled to protection against the imposition of such penalties as would virtually deny access to the courts for the protection of rights guaranteed by the Federal Constitution. *Ex parte Young*, 209 U.S., p. 147; *Willcox* v. *Consolidated Gas Co.*, 212 U.S. 19, 53, 54; *Missouri Pacific Rwy.* v. *Tucker*, 230 U.S. 340, 351; *Ohio Tax Cases*, 232 U.S. 576, 587; *Wadley Southern Rwy.* v. *Georgia*, 235 U.S. 651. The allegations of the bill show no ground for dispensing with efforts to procure action by the corporation; and in this view, without discussing the merits of the case, we are of the opinion that the complainant was not entitled to the injunction sought.

Order affirmed.

NOTE. — Rule 27 of the Rules of Practice in Equity, promulgated by the U.S. Supreme Court, and in force on and after February 1, 1913 (taking the place of Rule 94 of the Rules adopted in 1882), is as follows: "Every bill brought by one or more stockholders in a corporation against the corporation and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since by operation of law, and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance. It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders, and the causes of his failure to obtain such action, or the reasons for not making such effort."

Personal exception to the plaintiff. If the plaintiff has approved of the corporate action, now complained of, or has taken any benefit to himself from it, such fact is, without more, a sufficient defense to a suit instituted by him. *Wormser* v. *Metropolitan Street Ry. Co.*, 184 N.Y. 83.

It has been held that, if the plaintiff is a puppet, acting in behalf

of some third person having interests hostile to the corporation, such fact is a defense. *Forrest* v. *Manchester Ry. Co.*, 4 De Gex, Fisher & Jones, 126; *Jenkins* v. *Auburn City Ry. Co.*, 27 N.Y. App. Div. 553. But cf. *Central R.R. Co.* v. *Collins*, 40 Ga. 582; *Carver* v. *Southern Iron Co.*, 78 N.J. Eq. 81, 94.

There is authority that if the plaintiff is suing for his own purposes, the court will not inquire into his motives. *Seaton* v. *Grant*, L.R. 2 Ch. 459.

H. Rights of Persons who became Stockholders at a time subsequent to the Commission of the Alleged Wrong.

POLLITZ *v.* GOULD.

202 N.Y. 11. 1911.

Appeal, by permission, from an order of the Appellate Division of the Supreme Court in the first judicial department, entered January 13, 1911, which affirmed an order of Special Term denying a motion to dismiss the complaint upon the pleading.

The following questions were certified: "1. Does the fact that the plaintiff acquired his stock of the defendant, the Wabash Railroad Company, upon which he bases his right to ask the court to enforce a cause of action in favor of the railroad company against the individual defendants, after all the transactions which the plaintiff insists imposed a liability in favor of the railroad company against the individual defendants had been consummated, all stocks and bonds issued and the transactions complained of in all respects completed, prevent the plaintiff from maintaining this action? 2. Is the enforcement of such a cause of action confined to stockholders who actually owned stock at the time the transactions complained of were consummated and completed?"

Hiscock, J. This action was brought by plaintiff as a stockholder in the Wabash Railroad Company in behalf of said company for the benefit of himself and all other stockholders to set aside as fraudulent a transfer and exchange of several millions of dollars par value of its stock for an equivalent amount of the capital stock of the Wabash Pittsburg Terminal Railway Company. It is unnecessary to go into the details of the transaction which is being attacked by the plaintiff through and in behalf of the company, for the sole question presented for our consideration may be discussed without doing this. This question is whether a stockholder may bring an action of this character for the purpose of avoiding an improper transaction consummated at the expense of the corporation before he acquired his stock, and as presented here the question is unembarrassed by

any incidental considerations, as, that the prior holder of the stock consented to the transaction or that plaintiff's subsequent acquisition of the stock was accompanied by any circumstances which would render it inequitable for him to seek relief.

While somewhat strangely this question does not appear to have been decided by this court, it has been passed on by the lower courts of this state and by those of many other states and by the Supreme Court of the United States. It has also been somewhat considered by the courts of England. Conflicting conclusions have been reached by these decisions. Without reviewing the English authorities, which so far as cited do not seem to be very decisive, reference may be made to the decisions in this country.

The question was presented in *Hawes* v. *Oakland*, 104 U.S. 450, and it was there held that a stockholder might not bring an action in behalf of the corporation to avoid a fraudulent transaction consummated before he acquired his stock. While the question was directly passed on it is fair to state that it was not considered at any great length and that the court seems to have been more concerned with establishing this rule as one of practice than of substantive law. The decision resulted in the adoption of a rule requiring the plaintiff in such an action to show before bringing suit that he owned the stock on which it was brought at the time the transaction complained of occurred, and whether it be regarded as establishing a principle of law or a rule of practice this authority has been subsequently followed in the United States courts.

In addition, this rule in such a stockholder's action has been approved in the following cases: *Alexander* v. *Searcy*, 81 Ga. 536; *Boldenweek* v. *Bullis*, 40 Colo. 253; *Rankin* v. *S. W. B. & I. Co.*, 12 N. Mex. 54; *Moore* v. *Silver Valley Co.*, 104 N.C. 534; *Clark* v. *American Coal Co.*, 86 Ia. 436; *Home Fire Ins. Co.* v. *Barber*, 67 Neb. 644.

The contrary doctrine that a stockholder acquiring his stock subsequent to the occurrence complained of may maintain this character of an action has been affirmed in the following cases outside of this state: *Winsor* v. *Bailey*, 55 N.H. 218; *City of Chicago* v. *Cameron*, 22 Ill. App. 91 (affirmed, 120 Ill. 447); *Montgomery Light & Power Co.* v. *Lahey*, 121 Ala. 131; *Forrester* v. *B. & M., etc., Co.*, 21 Mont. 544, 565; *Just* v. *Idaho, etc., Co.*, 102 Pac. Rep. 381; *Rafferty* v. *Donnelly*, 197 Pa. St. 423; *Appleton* v. *Am. Malting Co.*, 65 N.J. Eq. 375.

It has also been approved in this state directly or indirectly in the following cases: *Ramsey* v. *Gould*, 57 Barb. 398; *Young* v. *Drake*, 8 Hun, 61; *Ervin* v. *Oregon Ry. & N. Co.*, 35 Hun, 544; *Frothingham* v. *Broadway & Seventh Ave. R.R. Co.*, 9 Civ. Pro. Rep. 304; *Sayles* v. *Central Nat. Bank*, 18 Misc. Rep. 155; *O'Connor* v. *Virginia P. & P. Co.*, 46 Misc. Rep. 530, 535.

Assuming this question to be an open one in this court, we have

no hesitation in approving the rule which has heretofore prevailed in this state, that in the absence of special circumstances this character of action may be maintained by a stockholder acquiring his stock subsequent to the transaction which is challenged, rather than the contrary one prevailing elsewhere. We do this not only because a long and uniform line of decisions by our own courts ought to have weight, but because the rule established by these decisions seems to be the sounder one.

A stockholder has an indivisible interest in the property and assets of a corporation subject to the discharge of its obligations. This indivisible interest generally speaking is represented by certificates of stock and is transferred by their transfer. The general character of these certificates and the effect of their transfer in passing the interest of the holder is too well established and understood to require any discussion. As an original proposition it would seem to be clear that a right of action by or in behalf of the corporation for fraud to set aside a conveyance of its assets or to avoid obligations imposed upon it is part of its rights, property and assets in which a stockholder has this indivisible interest transferable by the transfer of his certificates. I am unable to see any real or substantial distinction by virtue of which a stockholder transferring his certificates would transfer all of his indivisible interest in bonds or real estate on hand, but would not transfer his interest in a right of action to recover bonds or real estate which had been fraudulently withdrawn from the possession of the corporation, and which it was entitled to recover. And if the subsequent holder by acquiring the certificates does acquire such latter interest, it seems to follow that he may if necessary, in behalf of the corporation, assert and prosecute an action to protect and enforce the same.

Brief reference may be made to some of the reasons advanced in opposition to this view. Counsel points out practical inconvenience which he says will result from its application owing to the difficulties in tracing stock and distinguishing that which has not assented to the transaction from that which has or from that which perhaps has been issued since its consummation. These arguments, however, are so counterbalanced by corresponding claims from the opposite standpoint as to be of little weight.

Again, it is argued that if one buys stock subsequent to the transaction he should be regarded as buying subject to it and not be permitted to question it. If the prior holder should give binding consent to the transaction, this under certain circumstances undoubtedly would prevent the subsequent purchaser from questioning it. But, in the absence of special circumstances, I fail to see any principle of estoppel or logic which makes a subsequent purchase of stock so subject to a fraudulent corporate transaction that the purchaser may not insist upon its being set aside. There is scarcely any analogy

between the situation of one who buys from an individual some property which has been subjected to a transaction which has not been disaffirmed and that of one who purchases stock in a corporation which has the continuing right both before and after the purchase to disaffirm a wrong which has been perpetrated on it by its agents. There is little or no basis for the practical consideration that one who buys stock should be deemed to have adjusted his price to an existing transaction even though voidable. If he knows of it he may just as properly be assumed to have adjusted his price to the knowledge that the transaction may still be disaffirmed and avoided.

Then, lastly, an argument is made which seems to be founded on the idea that in order to bring an action of this nature the stockholder must in effect disaffirm the corporate transaction and that this disaffirmance involves a personal right of election which vests in the one holding the stock when the transaction is consummated and which cannot be transferred. It is said "the right to question a fraud is not a purchasable commodity," and is not "capable of assignment and transfer," and does not pass "as an implied incident to every sale of corporate stock," and this view seems to be supported by some of the many cases which have been collected and reviewed by counsel with manifest industry and care.

So far as this argument means to assert that a mere naked right to question a corporate transaction could not be transferred to a stranger, if such an attempt can be conceived of, it may be assumed to be true. But the assertion that the right to protect stock by procuring an improper corporate transaction to be vacated does not pass on a transfer of the stock is a very different proposition.

The election to disaffirm a fraudulent corporate transaction belongs to and is exercised in the right and name of the corporation and not of the stockholder. The stockholder demands that the right shall be exercised and the cause of action be prosecuted by the corporation or does it himself for the corporation. It is conceded that the one holding the stock when the fraud is consummated has this right. When he transfers his certificates the transaction still stands a continuing wrong impairing the surplus of the company and affecting the stock. If the transferee has the right to have it avoided this will protect and increase the value of his stock. If he has not acquired this right it is the only one held by his predecessor in or through the corporation, which has been thought of, which has not been transferred by the transfer of the stock. It will be an anomalous exception if the prior holder retains the right to maintain or have maintained this action while he passes all of his other rights by the transfer of his stock. The only justification pleaded for this is the idea suggested of a personal and non-transferable right of election to disaffirm vested in the original holder. But this theory is entirely unsubstantial. Such prior holder does not acquire this right to object

to the transaction and bring an action to set it aside as a power conferred upon him by reason of any personal qualities, but because of his character as a stockholder, and when he loses this character and transfers it to another with his stock there is no reason why the latter should not exercise the right as a proper and necessary incident to his stock ownership.

The order should be affirmed, with costs, and both questions certified to us answered in the negative.

CULLEN, Ch.J., VANN, WERNER, WILLARD BARTLETT and CHASE, JJ., concur; HAIGHT, J., absent.

Order affirmed.

PARSONS *v.* JOSEPH.

92 Ala. 403. 1890.

THE bill in this case was filed on the 19th day of July, 1890, by Henry Joseph, as a stockholder in the Birmingham, Powderly & Bessemer Street Railroad Company, against the said corporation and J. H. Parsons; and sought the cancellation of certain certificates of stock issued by the corporation to said Parsons, on the ground that the stock was fictitious and fraudulent. There was a demurrer to the bill, and a motion to dissolve the injunction, each of which was overruled; and this appeal is sued out by the defendants from that interlocutory decree.

COLEMAN, J. Among other averments, the bill substantially alleges that plaintiff is a *bona fide* stockholder in said company; that shortly after the organization of the company, the defendant subscribed for one hundred and seven shares of the capital stock of the company, of the par value of fifty dollars each, and paid for the same in full by conveying to the company thirty-nine acres of land (describing the land) at an agreed price and valuation of one hundred and thirty-seven dollars per acre, when the land was not worth more than twenty-five dollars per acre, and for this land Parsons was to receive one hundred and seven shares of the stock; that shortly thereafter, the capital stock of the company was doubled, and without further consideration than the thirty-nine acres of land, Parsons' stock was doubled, and he received two hundred and fourteen shares of the capital stock. The bill, as amended, charges the excessive valuation of the land was made knowingly, willfully, and with the fraudulent intent of having issued to Parsons the fictitious stock, in violation of law. The answer denied that plaintiff was a *bona fide* stockholder, and set up that plaintiff was the transferee of one E. Lesser. The answer admits that defendant's stock was doubled without the payment of any additional consideration than that of the land; but by way of explanation and defense, avers that the lands

were not truly and properly valued at first, and the increased valuation of the lands only raised them to their real and true value, and the additional issue of stock was for property at its fair valuation. The answer continues, however, as follows: that if said transaction had been illegal and fraudulent, and not done in good faith, complainant is estopped from setting up fraud in said transaction, or seeking to cancel said stock, because E. Lesser, who was complainant's transferer, participated in all of said transactions and himself fixed the value of said lands, with full knowledge of and after full investigation of the value of said land.

A transferee of stock is not necessarily disqualified as a suitor in all cases, because the prior holders were personally disqualified. If the transferee purchased the shares in good faith, and without notice of the fact that the prior holder had precluded himself from suing, he would have as just a title to relief, as if he had purchased from a shareholder who was under no disability; but, if the purchaser was aware that the prior holder had barred his right to relief, neither justice nor public policy would require that the transferee, under these circumstances, should be accorded any greater rights than his transferer. Morawetz, § 267.

NOTE. — See also *Warren* v. *Robison*, 25 Utah, 205. The principal case is not, however, supported by the present weight of authority. Thus in *Babcock* v. *Farwell*, 245 Ill. 14, the court said (p. 41): "Neither can an assignee of stock maintain a suit in regard to transactions with the corporation done or assented to by his assignor. The purchaser of shares of stock acquires no greater rights than his vendor. He holds by the same title and subject to the same liability. Shares of stock are merely choses in action, and the successive owners acquire only the rights held by their predecessors in title." In support of this doctrine, see *Boldenweck* v. *Bullis*, 40 Colo. 253; *Callanan* v. *Windsor*, 78 Iowa, 193; *Trimble* v. *American Sugar Refining Co.*, 61 N.J. Eq. 340; *McCampbell* v. *Railroad*, 111 Tenn. 55.

It is submitted that, on principle, the principal case is sound. Three things are to be distinguished: (1) a right which is not transferable, such as a chose in action at the common law; (2) a right which is transferable, even by the casual holder who has acquired his holding in an improper fashion, such as a negotiable instrument; (3) a right which is transferable, but not by the casual holder. Now it is settled that shares of stock do not belong to the second class, and it is easy to reason from this that they are subject to all the rules governing ordinary choses in action. But shares of stock do not fall into the first class, but into the third. The objection to allowing a chose in action to be transferred was twofold: (1) it was conceived to be against public policy; and (2) it was conceived as a hardship upon an obligor to make him bound to some one to whom he had

not consented to be bound. But both of these objections drop when shares of stock are considered. The State, by granting the franchise of incorporation, has consented that there should be succession among the members. Nothing is more characteristic of a corporation than this "capacity for succession." This means that, where corporate membership is determined by the ownership of stock, the stock is transferable. Of course this is no hardship to the corporation.

There is therefore no good reason why the *bona fide* purchaser of a share of stock should not stand as well as the purchaser of land or a chattel. He gets the legal title, and he should hold that legal title free from equities or estoppels that would have bound his transferor.

Suppose A, president of X, misappropriates its assets. The stock is freely sold on the market, and is bought by purchasers on the supposition that the affairs of X are being honestly managed. B, an innocent stockholder, sells his stock to C. A sells some of his stock to D. C may require X to assert its right against A. *Pollitz* v. *Gould*, *supra*. Why should not D have a similar right?

The student should consider the cases in this subsection in connection with *Old Dominion Copper Co.* v. *Lewisohn*, p. 341, *supra; Old Dominion Copper Co.* v. *Bigelow*, p. 349, *supra*, and the cases on "Setting Aside Ultra Vires Transactions," p. 753, *supra*.

SECTION 2.

TRANSFER OF SHARES.

TISDALE *v.* HARRIS.

20 Pick. (Mass.) 9. 1838.

Assumpsit on an oral agreement of the defendant, to sell to the plaintiff two hundred shares, with all the earnings thereon, in a Connecticut corporation.

Verdict for plaintiff. Motion to set aside verdict. One ground of the motion was, because the contract set up was within the statute of frauds.

Shaw, C.J. [After deciding another question.] But by far the most important question in the case, arises on the objection, that the case is within the statute of frauds. This statute, which is copied precisely from the English statute, is as follows: "No contract for the sale of goods, wares or merchandise for the price of ten pounds ($33.33) or more, shall be allowed to be good, except the purchaser shall accept part of the goods so sold, and actually receive the same or give something in earnest to bind the bargain, or in part payment, or that some note or memorandum in writing of the said bargain, be made and signed by the parties to be charged by such contract, or their agent, thereunto lawfully authorized."

This being a contract for the sale of shares in an incorporated company in a neighboring State, for the price of more than ten pounds, and no part having been delivered, and no purchase money or earnest paid, the question is, whether it can be allowed to be good, without a note or memorandum in writing, signed by the party to be charged with it. This depends upon the question, whether such shares are goods, wares or merchandise within the true meaning of the statute.

It is somewhat remarkable that this question, arising on the *St.* 29 *Car.* 2, in the same terms, which ours has copied, has not been definitively settled in England. In the case of *Pickering* v. *Appleby*, Com. Rep. 354, the case was directly and fully argued, before the twelve judges, who were equally divided upon it. But in several other cases afterwards determined in Chancery, the better opinion seemed to be, that shares in incorporated companies, were within the statute, as goods or merchandise. *Mussell* v. *Cooke*, Prec. in Ch. 533; *Crull* v. *Dodson*, Sel. Cas. in Ch. 41.

We are inclined to the opinion, that the weight of authorities, in modern times, is, that contracts for the sale of stocks and shares in

incorporated companies, for more than ten pounds, are not valid, unless there has been a note or memorandum in writing, or earnest or part payment. 4 Wheaton, 89, note; 3 Starkie on Evid. 4th Amer. Edit. 608.

Supposing this a new question now for the first time calling for a construction of the statute, the Court are of opinion that as well by its terms, as its general policy, stocks are fairly within its operation. The words "goods" and "merchandise," are both of very large signification. *Bona,* as used in the civil law, is almost as extensive as personal property itself, and in many respects it has nearly as large a signification in the common law. The word "merchandise" also, including in general objects of traffic and commerce, is broad enough to include stocks or shares in incorporated companies.

There are many cases indeed in which it has been held in England, that buying and selling stocks did not subject a person to the operation of the bankrupt laws, and thence it has been argued that they cannot be considered as merchandise, because bankruptcy extends to persons using the trade of merchandise. But it must be recollected that the bankrupt acts were deemed to be highly penal, and coercive, and tended to deprive a man in trade of all his property. But most joint-stock companies were founded on the hypothesis at least, that most of the shareholders took shares as an investment and not as an object of traffic; and the construction in question only decided, that by taking and holding such shares merely as an investment, a man should not be deemed a merchant so as to subject himself to the highly coercive process of the bankrupt laws. These cases, therefore, do not bear much on the general question.

The main argument relied upon, by those who contend that shares are not within the statute, is this. That statute provides that such contract shall not be good, etc., among other things, except the purchaser shall accept part of the goods. From this it is argued, that by necessary implication, the statute applies only to goods, of which part may be delivered. This seems however to be rather a narrow and forced construction. The provision is general, that no contract for the sale of goods, etc., shall be allowed to be good. The exception is, when part are delivered; but if part cannot be delivered, then the exception cannot exist to take the case out of the general prohibition. The provision extended to a great variety of objects, and the exception may well be construed to apply only to such of those objects to which it is applicable, without affecting others, to which from their nature it cannot apply.

There is nothing in the nature of stocks, or shares in companies which in reason or sound policy should exempt contracts in respect to them from those reasonable restrictions, designed by the statute, to prevent frauds in the sale of other commodities. On the contrary, these companies have become so numerous, so large an amount of the

property of the community is now invested in them, and as the ordinary *indicia* of property, arising from delivery and possession, cannot take place, there seems to be peculiar reason for extending the provisions of this statute to them. As they may properly be included under the term goods, as they are within the reason and policy of the act, the Court are of opinion, that a contract for the sale of shares, in the absence of the other requisites, must be proved by some note or memorandum in writing; and as there was no such memorandum in writing, in the present case, the plaintiff is not entitled to maintain this action. As to the argument, that here was a part performance, by a payment of the money on one side, and the delivery of the certificate on the other, these acts took place after this action was brought, and cannot therefore be relied upon to show a cause of action when the action was commenced.

Verdict set aside and plaintiff nonsuit.

Note. — See, *accord*, *North* v. *Forest*, 15 Conn. 400; *Hightower* v. *Ansley*, 126 Ga. 8 (overruling *Rogers* v. *Burr*, 105 Ga. 432); *Pray* v. *Mitchell*, 60 Me. 430; *Sprague* v. *Hosie*, 155 Mich. 30; *Tompkins* v. *Sheehan*, 158 N.Y. 617. See also *Southern Life Insurance Co.* v. *Cole*, 4 Fla. 359, 378 (statute covers contracts for the sale of "any personal property, goods, wares, or merchandise"); *Snow Storm Co.* v. *Johnson*, 186 Fed. 745 (statute covered sale of "things in action").

See, *contra*, *Duncuft* v. *Albrecht*, 12 Sim. 189. See also *Vawter* v. *Griffin*, 40 Ind. 593, 602; *Webb* v. *Baltimore Co.*, 77 Md. 92, 98; *Seddon* v. *Rosenbaum*, 85 Va. 928.

Ryers v. *Tuska*, 14 N.Y. Supp. 926. A contract for the sale of stocks, of which there is no memorandum in writing, as required by the statute of frauds, cannot be enforced, though the contract was made in a stock exchange of which both parties were members, the constitution and by-laws of which provides that "all offers to buy and sell securities shall be binding," and that "any member who may fail to comply with his contracts, or who may become insolvent, shall be suspended until he has settled with his creditors."

EAST BIRMINGHAM LAND CO. *v.* DENNIS.

85 Ala. 565. 1888.

Appeal from the City Court of Birmingham, in equity.

Heard before the Hon. H. A. Sharpe.

The bill in this case was filed on the 13th April, 1888, by J. F. Dennis, against J. P. Mudd, and the East Birmingham Land Company, a private corporation; and sought to compel the transfer, on the books of the corporation, of a certificate for ten shares of stock,

of which the complainant claimed to be the owner, and to compel the delivery of the certificate to him by said Mudd, who had possession of it under claim of ownership. The certificate was issued in the name of A. R. Dearborn, and was indorsed by him in blank. The complainant claimed that he had bought the certificate, with the blank indorsement thereon, from a holder who had acquired it by purchase from said Dearborn; and that it was lost by him, or stolen from him, without fault on his part. Mudd purchased the certificate, for full value, from Wilson, Sage & Clark, stockbrokers in Birmingham; and while denying complainant's ownership, claimed that he acquired a good title by the custom and usage of brokers and merchants in Birmingham. A decree *pro confesso* was taken against the corporation. On final hearing, on pleadings and proof, the court rendered a decree for the complainant; and this decree is now assigned as error, by each of the defendants separately.

SOMERVILLE, J. We concur in the conclusion reached by the judge of the City Court, that the appellee, Dennis, complainant in the bill, is the owner of the ten shares of stock which are the subject of litigation in the present suit. The testimony satisfactorily proves that the certificate of stock, indorsed in blank by Dearborn, who was the owner on the books of the defendant corporation, was the property of the appellee, and was taken or stolen from his possession, without any negligence on his part whatever, several months before it was purchased by the defendant Mudd, who innocently bought and paid value for it, some time in March, 1888.

The only question is, whether Mudd, who paid full value for this stock, without notice of the complainant's claim to it, acquired a title superior to that of complainant.

The established rule is that no person can ordinarily be deprived of his ownership of property save by his own consent, or his negligence. The only exception to this rule is the case of a *bona fide* purchaser for value, of negotiable paper. We have no reference, of course, to the taking of property for public uses by judicial condemnation, which may be done without the owner's consent.

It can not be contended, with any degree of plausibility, that, under the facts of this case, the complainant was guilty of negligence, or the want of ordinary care in the custody of the certificate. He kept it in a box in the vault of a banking-house, whence it was abstracted by some unknown person, apparently, without any fault on his part.

Nor does any question arise involving the rights of a subsequent *bona fide* purchase of stock, from one shown to be owner on the corporate books, who has already made a prior unregistered transfer of it to another purchaser. All such transfers made by the true owner, and not registered on the books of the corporation within fifteen days, are declared by statute to be "void as to *bona fide* creditors, or

purchasers without notice." — Code 1886, § 1671; *Fisher* v. *Jones*, 82 Ala. 117. If the defendant Mudd had claimed by a subsequent purchase from Dearborn, the owner of the stock on the corporate books, this question would arise. But he does not so claim, his title being derived through the complainant Dennis himself, by two or more intermediate transferees, the first of whom was a fraudulent holder without title. Whether Mudd's title to the stock, therefore, is superior to that of Dennis, depends on whether a certificate of stock, indorsed in blank by the owner, is to be treated as negotiable paper.

The rule is well settled, that a *bona fide* purchaser of a negotiable bill, bond or note, although he buys from a thief, acquires a good title, if he pays value for it without notice of the infirmity of his vendor's title. The authorities are clear in support of the view, that a certificate of corporate shares of stock, in the ordinary form, is not negotiable paper, and that a purchaser of such certificate, although indorsed in blank by the owner, where no question arises under the registration laws, obtains no better title to the stock than his vendor had, in the absence of all negligence on the part of the owner, or his authority to make the sale. This question arose, and was decided by the New York Court of Appeals, in *Mechanics' Bank* v. *New York & New Haven R.R. Co.*, 13 N.Y. (1856), 599. It was there held, that such a certificate does not partake of the character of a negotiable instrument, and that a *bona fide* assignee, with full power to transfer the stock, takes the certificate subject to the equities which existed against his assignor. Such certificates, said COMSTOCK, J., "contain no words of negotiability. They declare simply that the person named is entitled to certain shares of stock. They do not, like negotiable instruments, run to the bearer, or order of the party to whom they are given." They were said to be, in some respects, like a bill of lading, or warehouse receipt, being "the representative of property existing under certain conditions, and the documentary evidence of title thereto." The most that can be said is, that all such instruments possess a sort of *quasi* negotiability, dependent on the custom of merchants and the convenience of trade. They are not, in the matter of transferability, protected strictly as negotiable paper.

In *Shaw* v. *Spencer*, 100 Mass. 382; s.c., 97 Amer. Dec., 1 Amer. Rep. 115 (1868), it was also decided that a certificate of corporate stock, transferred in blank on its back, was clearly not a negotiable instrument. "No commercial usage," it was said, "could give to such an instrument the attribute of negotiability. However many intermediate hands it may pass through, whoever would obtain a new certificate in his own name, must fill out the blanks, . . . so as to derive title to himself directly from the last recorded stockholder, who is the only recognized and legal owner of the shares." The case of *Sewall* v. *Boston Water Power Co.*, 4 Allen, 282; s.c., 81 Amer. Dec.

701, decided by the same court a few years before, is referred to as a precedent in support of this conclusion.

The precise point in the present case was also decided in *Barstow* v. *Savage Mining Co.*, 64 Cal. 388; s.c., 49 Amer. Rep. 705, where it was expressly held that a *bona fide* purchaser of stock standing on the company's books in the name of the former owner, regularly indorsed by him, and stolen from the present owner without his fault, gets no title. The decision was based on the fact, that such certificates are not negotiable instruments, but simply muniments of title, and evidences of the holder's right to a given share in the property and franchises of the corporation. It was observed, in regard to the matter of negligence, as follows: "But, if the purchaser from one who has not the title, and has no authority to sell, relies for his protection on the negligence of the true owner, he must show that such negligence was the proximate cause of the deceit."

The same principle was applied to bills of lading, in *Gurney* v. *Behrend*, 3 Ellis & Bl. 622, decided by the English Queen's Bench, where an instrument of that kind, indorsed in blank by the consignor, and sent by him to his correspondent, had been misappropriated. The correspondent, without authority, fraudulently transferred the bill for value; and it was held by Lord Campbell, that for the want of the element of negotiability in the paper, the title to the goods was unaffected by the transaction.

The doctrine of *Barstow* v. *Savage Mining Co.*, *supra*, is well supported by authority, and, in our judgment, announces a correct principle of law, and we fully approve it. — *Woolley* v. *Sargeant*, 14 Amer. Dec., NOTE, on page 427, and cases there cited; Cook on Stock and Stockholders, §§ 368, 437, 192, 7, 10; 2 Daniel's Neg. Instr. (3d Ed.), § 1708*g*. It harmonizes entirely with the declaration of our statute, that shares of stock in private corporations "are personal property, transferable on the books of the corporation" in accordance with the rules and regulation of the corporation. — Code 1886, § 1669; *Campbell* v. *Woodstock Iron Co.*, 83 Ala. 451.

There is a class of cases, not to be confounded with the one in hand, where the holder of such a certificate of stock, indorsed in blank, is clothed with power as agent or trustee, to deal with such stock to a limited extent, and transfers it by exceeding his powers, or in breach of his trust. In such cases, it has often been held that the true owner, having conferred on the holder, by contract, all the external *indicia* of title, and an apparently unlimited power of disposition over the stock, "is estopped to assert his title as against a third person, who, acting in good faith, acquires it for value from the apparent owner." — 2 Dan. Neg. Inst. (3d Ed.), § 1708*g*; *McNeil* v. *Tenth Nat. Bank*, 46 N.Y. 325; *Mount Holly Turnpike Co.* v. *Ferree*, 17 N.J. Eq. 117; *Prall* v. *Tilt*, 28 *Ib.* 479; *Merchant's Nat. Bank* v. *Livingston*, 74 N.Y. 223. These cases rest on the principle,

that it is more just and reasonable, where one of two innocent parties must suffer loss, that he should be the loser who has put trust and confidence in the deceiver, than a stranger who has been negligent in trusting no one." — *Allen* v. *Maury & Co.*, 66 Ala. 10.

It being an established principle of law, that certificates of stock are not to be regarded as negotiable paper, it is not permissible to prove a custom or usage among stock-brokers to the contrary. No usage is good which conflicts with an established principle of law, any more than one which contravenes or nullifies the express stipulations of a contract. *Dickinson* v. *Gay*, 83 Amer. Dec. 656, and note, 664; *E. T., Va. & Ga. R.R. Co.* v. *Johnston*, 75 Ala. 576; *Lehman* v. *Marshall*, 47 Ala. 362.

The decree of the court below is in accordance with these views, and must be affirmed.

NOTE. — There are several cases, *accord.* For recent cases, see *Schumacher* v. *Greene Cananea Co.*, 117 Minn. 124; *Barstow* v. *City Trust Co.*, 216 Mass. 330.

Swim v. *Wilson*, 90 Cal. 126. If a stock-broker, acting in good faith, receives from a thief certificates of stock indorsed in blank, sells them, and pays the net proceeds to the thief, he converts the stock. See Warren's *Cases on Property*, p. 400.

McNEIL *v.* TENTH NATIONAL BANK.

46 N.Y. 325. 1871.

THE plaintiff pledged with Goodyear Brothers & Durant, stockbrokers, certain certificates of stock endorsed in blank. These were tortiously pledged by the stockbrokers to Fred. Butterfield, Jacobs & Co. for a debt larger than the debt due from the plaintiff. The defendant, at the request of the stockbrokers, paid Butterfield, Jacobs & Co. and took the pledged securities from them. The question was whether plaintiff was entitled to the certificates on paying the defendant the amount due from him to the stockbrokers, or whether the defendant was entitled to be treated as a pledgee of the certificates for the amount due from the stockbrokers to them.

RAPALLO, J. The pledge of the plaintiff's shares by his brokers, for a larger sum than the amount of their lien thereon, was a clear violation of their duty, and excess of their actual power. And if the effect of the transaction was merely to transfer to the appellant, through Fred. Butterfield, Jacobs & Co., the title or interest of Goodyear Brothers & Durant in the shares, the judgment appealed from was right.

It must be conceded, that as a general rule, applicable to property

other than negotiable securities, the vendor or pledgor can convey no greater right or title than he has. But this is a truism, predicable of a simple transfer from one party to another where no other element intervenes. It does not interfere with the well-established principle, that where the true owner holds out another, or allows him to appear, as the owner of, or as having full power of disposition over the property, and innocent third parties are thus led into dealing with such apparent owner, they will be protected. Their rights in such cases do not depend upon the actual title or authority of the party with whom they deal directly, but are derived from the act of the real owner, which precludes him from disputing, as against them, the existence of the title or power which, through negligence or mistaken confidence, he caused or allowed to appear to be vested in the party making the conveyance. *Pickering* v. *Busk*, 15 East, 38; *Gregg* v. *Wells*, 10 Adol. & El. 90; *Saltus* v. *Everett*, 20 Wend. 268, 284; *Mowrey* v. *Walsh*, 8 Cow. 238; *Root* v. *French*, 13 Wend. 570.

The true point of inquiry in this case is, whether the plaintiff did confer upon his brokers such an apparent title to, or power of disposition over, the shares in question, as will thus estop him from asserting his own title, as against parties who took *bona fide* through the brokers.

Simply intrusting the possession of a chattel to another as depositary, pledgee or other bailee, or even under a conditional executory contract of sale, is clearly insufficient to preclude the real owner from reclaiming his property, in case of an unauthorized disposition of it by the person so intrusted. *Ballard* v. *Burgett*, 40 N.Y. R. 314. "The mere possession of chattels, by whatever means acquired, *if there be no other evidence of property or authority to sell from the true owner*, will not enable the possessor to give a good title." Per DENIO, J., in *Covill* v. *Hill*, 4 Den. 323.

But if the owner intrusts to another, not merely the possession of the property, but also written evidence, over his own signature, of title thereto, and of an unconditional power of disposition over it, the case is vastly different. There can be no occasion for the delivery of such documents, unless it is intended that they shall be used, either at the pleasure of the depositary, or under contingencies to arise. If the conditions upon which this apparent right of control is to be exercised, are not expressed on the face of the instrument, but remain in confidence between the owner and the depositary, the case cannot be distinguished in principle, from that of an agent who receives secret instructions qualifying or restricting an apparently absolute power.

In the present case, the plaintiff delivered to and left with his brokers, the certificate of the shares, having indorsed thereon the form of an assignment, expressed to be made "for value received," and an irrevocable power to make all necessary transfers. The name of the transferee and attorney, and the date, were left blank. This

document was signed by the plaintiff, and its effect must be now considered.

It is said in some English cases, that blank assignments of shares in corporations are irregular and invalid; but that opinion is expressed in cases where the shares could only be transferred by deed under seal, duly attested, and is placed upon the ground that a deed cannot be executed in blank.

Without referring to the American doctrine on that subject, it is sufficient to say that no such formality was requisite in this case. It was only necessary to a valid transfer as between the parties, that the assignment and power should be in writing. The common practice of passing the title to stock by delivery of the certificate with blank assignments and power, has been repeatedly shown and sanctioned in cases which have come before our courts. Such was established to be the common practice in the city of New York, in the case of the *New York and New Haven Railroad Company* v. *Schuyler*, 34 N.Y. 41, and the rights of parties claiming under such instruments were fully recognized in that case. And in the case of *Kortright* v. *The Commercial Bank of Buffalo* (20 Wend. 91, and 22 Wend. 348), the same usage was established as existing in New York and other States, and it was expressly held that even in the absence of such usage, a blank transfer on the back of the certificate, to which the holder has affixed his name, is a good assignment; and that a party to whom it is delivered is authorized to fill it up, by writing a transfer and power of attorney over the signature. . . .

The holder of such a certificate and power, possesses all the external *indicia* of title to the stock, and an apparently unlimited power of disposition over it. He does not appear to have, as is said in some of the authorities cited, concerning the assignee of a chose in action, a mere equitable interest, which is said to be notice to all persons dealing with him that they take subject to all equities, latent or otherwise, of third parties; but, apparently, the legal title, and the means of transferring such title in the most effectual manner.

Such, then, being the nature and effect of the documents with which the plaintiff intrusted his brokers, what position does he occupy toward persons who, in reliance upon those documents, have in good faith advanced money to the brokers or their assigns on a pledge of the shares? When he asserts his title, and claims, as against them, that he could not be deprived of his property without his consent, cannot he be truly answered that, by leaving the certificate in the hands of his brokers, accompanied by an instrument bearing his own signature, which purported to be executed for a consideration, and to convey the title away from him, and to empower the bearer of it irrevocably to dispose of the stock, he in fact "substituted his trust in the honesty of his brokers, for the control which the law gave him over his own property," and that the consequences of a betrayal of

that trust, should fall upon him who reposed it, rather than upon innocent strangers from whom the brokers were thereby enabled to obtain their money? . . .

My conclusion is, that the Tenth National Bank must, on the facts found, be deemed to have advanced *bona fide* on the credit of the shares, and of the assignment and power executed by the plaintiff, and is entitled to hold the stock for the full amount so advanced, and remaining unpaid after exhausting the other securities received for the same advance.

NOTE. — See, *accord, Nelson* v. *Owen,* 113 Ala. 372; *Brittan* v. *Oakland Bank,* 124 Cal. 282; *Otis* v. *Gardner,* 105 Ill. 436; *Baker* v. *Davie,* 211 Mass. 429; *Walker* v. *Detroit Transit Co.,* 47 Mich. 338; *Gass* v. *Hampton,* 16 Nev. 185; *Mount Holly Co.* v. *Ferree,* 17 N.J. Eq. 117; *Beckwith* v. *Galice Mines Co.,* 50 Or. 542; *Wood's Appeal,* 92 Pa. 379; *State Bank* v. *Cox,* 11 Rich. Eq. (S.C.) 344; *Cherry* v. *Frost,* 7 Lea (Tenn.) 1; *Strange* v. *H. & T. C.R. R. Co.,* 53 Tex. 162. See also *American Exchange Bank* v. *Woodlawn Cemetery,* 194 N.Y. 116, 126.

See, *contra, Merchants' Bank* v. *Williams,* 110 Md. 334.

CLEWS *v.* FRIEDMAN.

182 Mass. 555. 1903.

BILL IN EQUITY, filed June 20, 1902, against the trustee in bankruptcy of A. H. Zunz to restrain him from enforcing an attachment against four shares of the capital stock of the Boston and Albany Railroad Company, attached as the property of Rosa W. Zunz, who sold the shares to the plaintiffs.

The bill alleged, that the plaintiffs were copartners carrying on a banking business in the city of New York, that on March 1 or 2, 1900, Rosa W. Zunz, being the owner of the certificate representing the four shares of stock in question and having owned it since October 17, 1899, sold and delivered it to the plaintiffs, together with a written transfer of it signed by her on the back of the certificate, and that the plaintiffs purchased the certificate from her in good faith and paid her for it the full market value of $239.75 per share; that on March 3, 1900, the plaintiffs caused the certificate to be presented to the railroad company for transfer to them, and the plaintiffs then for the first time learned, that on February 20, 1900, the defendant, Friedman, as trustee in bankruptcy of one A. H. Zunz, had brought an action in the Superior Court against Rosa W. Zunz, for $5,000, and on February 21, 1900, had caused the writ in that action to be served upon the railroad company by an attachment of the four shares of stock standing in her name; and that the railroad company

refused to make the requested transfer to the plaintiffs unless and until the attachment should be dissolved.

The answer admitted all the allegations of the bill.

It was agreed that the following was a by-law of the Boston and Albany Railroad Company: "Art. VII. The directors shall be, and they are hereby authorized to determine the form of the certificates for the capital stock of the corporation, and the manner of transferring and recording the same. They shall also establish a corporate seal, and determine the form thereof."

It was also agreed: "if competent and material, that by custom the certificates of stock in Massachusetts corporations, when endorsed in blank and delivered by the owner, are accepted by transferees like negotiable instruments, without inquiry as to the rights, if any, of third parties."

The case came on to be heard before HAMMOND, J., who reserved it for determination by the full court.

KNOWLTON, C.J. This case calls for a construction of the St. 1884, c. 229 (R. L. c. 109, § 37), which is as follows: "The delivery of a stock certificate of a corporation to a *bona fide* purchaser or pledgee, for value, together with a written transfer of the same, or a written power of attorney to sell, assign and transfer the same, signed by the owner of the certificate, shall be a sufficient delivery to transfer the title as against all parties; but no such transfer shall affect the right of the corporation to pay any dividend due upon the stock, or treat the holder of record as the holder in fact, until such transfer is recorded upon the books of the corporation, or a new certificate is issued to the person to whom it has been so transferred." This enactment was a new departure and a change of policy in the legislation of this Commonwealth. Previously to the St. 1881, c. 302, transfers of shares of railroad and manufacturing corporations and of many others, could not be made effectual against the rights of subsequent attaching creditors unless recorded on the books of the corporation. *Blanchard* v. *Dedham Gas Light Co.*, 12 Gray, 213; *Fisher* v. *Essex Bank*, 5 Gray, 373; Pub. Sts. c. 112, § 56. Except in reference to the small number of corporations in which there was no provision of statute or of the charter requiring a transfer to be made on the books of the corporation (see *Boston Music Hall Association* v. *Cory*, 129 Mass. 435) a creditor, by examining the books, could be certain to obtain a valid attachment against the owner of record. No purchaser of stock could be sure that his title was good against possible attachments without an examination of the books of the corporation, nor could he be protected against attachments that might be made subsequently, unless he recorded his transfer immediately. This St. 1881, c. 302, was enacted at the instance of purchasers and pledgees of stock, but it did not give them nearly all that they sought to obtain from the Legislature. It was in the nature of a compromise between

the conflicting interests of creditors and of those who desired that stock might safely be bought and sold by a transfer of the certificates from hand to hand. It left purchasers subject to the rights of creditors whose attachments had been made previously, and it gave every purchaser ten days in which to record his transfer before he could be affected by a subsequent attachment.

In 1884 purchasers and pledgees sought to obtain greater security and convenience, and the result was the statute now before us. By the language of the act "Delivery of a stock certificate . . . with a written transfer . . . signed by the owner of the certificate, shall be a sufficient delivery to transfer the title as against all parties." Here the certificate is treated as evidence of a title. The assignment is to be made by the owner of the certificate, and the transfer of the certificate transfers the title. What is meant by title? Evidently the title to the stock. A certificate in common form purports to represent a perfect title to the stock. The transfer of the certificate, by virtue of the statute, transfers the title referred to as against all parties, including attaching creditors. The statute declares in effect that an attachment shall be of no avail against a *bona fide* transaction of this kind. To obtain legislation of this kind was the purpose of the plaintiffs for the enactment, as is shown by the history of the proceedings which appears in the legislative proceedings. *Russell* v. *American Bell Telephone Co.*, 180 Mass. 467, discloses the existence of a usage that the possession of such a certificate, duly indorsed, enables the possessor to give title to a *bona fide* purchaser, good against everybody. The parties to this suit agree that by custom such certificates, indorsed in blank, and delivered by the owner, are accepted by transferees like negotiable instruments, without inquiry as to the rights, if any, of third persons. The case of *Andrews* v. *Worcester, Nashua, & Rochester Railroad*, 159 Mass. 64, 66, indicates that in the opinion of this court this usage is well founded in law. That this is the construction of the commissioners on the last revision of the statutes and of the Legislature that enacted the revision, appears by the R. L. c. 109, § 37, where the words "signed by the person named as the shareholder in such certificate," are substituted for the words, "signed by the owner of the certificate," and the words "against all persons" are substituted for "against all parties." A like construction seems to be put upon an identical statute by the Supreme Court of Wisconsin in *Wright Lumber Co.* v. *Hixon*, 105 Wis. 153, 158.

Except as affected by this statute the law authorizing the attachment of shares in a corporation is left in full force, and it is not necessary now to consider what remedy, if any, an attaching creditor would have, in equity or otherwise, to prevent the transfer of a certificate after an attachment.

Decree for the plaintiffs.

NOTE. — If by statute shares of stock are attachable by serving specified papers at the office of the corporation, and there is no countervailing statute in favor of *bona fide* purchasers of the certificate, a prior attaching creditor will prevail over the *bona fide* purchaser of the certificate. See *Young* v. *South Tredegar Co.*, 85 Tenn. 189.

If, however, the certificate has been indorsed and delivered to the purchaser prior to the attachment, it is submitted that the *bona fide* purchaser should be protected. A "transfer" of a chose in action can, it is true, only be made by way of novation, but the corporation has consented in advance to this novation, and it is therefore to be regarded as completed when the prior holder has delivered the certificate, so indorsed, to the new holder. Nor should a requirement in the by-laws of the company that its stock be "transferable only on the books of the corporation, on surrender of the certificate" change this result. The corporation will of course be protected in itself treating the registered holder as the owner, until it has notice of the transfer; but the requirement of registry should be interpreted as inserted only for the protection of the corporation, — just as the requirement that the certificate be surrendered on a transfer should be interpreted. The cases on this point are very numerous. The weight of authority supports this view. See *Smith* v. *American Coal Co.*, 7 Lans. (N.Y.) 317.

The law has been frequently changed by statute, so as to protect the *bona fide* purchaser even from a prior attachment.

This result necessarily limits the rights of creditors of the registered holders of stock.

See the Uniform Stock Transfer Act, sections 13 and 14.

Section 33 of No. 141 of the Public Acts of Vermont, 1915, provides as follows: "The delivery of a certificate of stock by the person named as the stockholder in such certificate or by a person entrusted by him with its possession for any purpose to a *bona fide* purchaser or pledgee for value, with a written transfer thereof, or with a written power of attorney to sell, assign or transfer the same, signed by the person named as the stockholder in such certificate, shall be a sufficient delivery to transfer title as against all persons, including creditors of the record holder; but no such transfer shall affect the right of the corporation to pay any dividend due upon the stock to the holder of record, or otherwise to treat the holder of record as the holder in fact, until it has been recorded upon the books of the corporation, or until a new certificate has been issued to the person to whom it has been transferred. Such transferee, upon delivery of the former certificate to the treasurer of the corporation, shall be entitled to receive a new certificate. No attachment or levy upon shares of stock shall be valid until such certificate is actually seized by the officer making the attachment or levy. A creditor of the stockholder shall be entitled to such aid from courts of appropriate jurisdiction,

by injunction or otherwise, as is allowed in regard to property which cannot readily be attached or levied upon by ordinary legal process."

In re BAHIA & SAN FRANCISCO RY. CO.

L.R. 3 Q.B. 584. 1868.

Miss Trittin was a shareholder in the Bahia & San Francisco Railway Company. The company accepted a transfer upon which her name had been forged, and issued new certificates to Stocken and Goldner which were sold to *bona fide* purchasers, Mr. Burton and Mrs. Goodburn.

The questions for the opinion of the court were: 1. Whether, as against the company, Mr. Burton and Mrs. Goodburn are entitled to the said shares in the company, or an equivalent number. 2. Whether they are entitled to any and what damages to be paid to them by the company under the above circumstances.

Blackburn, J. When joint-stock companies were established, the great object was that the shares should be capable of being easily transferred; and the legislature has made provision by 25 & 26 Vict. c. 89, § 25, that the company shall keep a register of the members, and when the capital is divided into shares, each share is to be distinguished by a number, and the shares held by each member is to be specified, and the dates at which each person's name was entered on the register. In order to keep up such a register, the company must alter its register whenever a transfer of shares is made, on the application and payment of a certain sum to them by the person to whom the shares are alleged to be transferred. And the first thing the company would have to do when a transfer was tendered to them, would be to inquire into its validity; but a company may be deceived, and induced, as the company were in the present case, without any negligence, to receive as genuine a forged transfer. They accordingly made an alteration in the register, and made it in fact inaccurate by putting the names of Stocken and Goldner on the register as the holders of particular shares, when in fact they were not so. The statute (§ 31) further provides that the company may give certificates, specifying the shares held by any member; and the object of this provision is expressly stated to be that this certificate should be *primâ facie* evidence of the title of the person named to the shares specified; and the company, therefore, by granting the certificate, do make a statement that they have transferred the shares specified to the person to whom it is given, and that he is the holder of the shares. If they have been deceived and the statement is not perfectly true, they may not be guilty of negligence, but the company, and no one else, have power to inquire into the matter; and it was the in-

tention of the legislature that these certificates should be documents on which buyers might safely act. Now, on the facts of this case, although according to the practice on the stock exchange, the claimants did not originally contract for these particular shares, the money was paid by them or their broker on the execution by Stocken and Goldner of a transfer, and on the certificate under the seal of the company being handed over to them that Stocken and Goldner were the holders of these particular shares; and it is quite clear that a statement of a fact was made by the company, on which the company, at the very least, knew that persons wanting to purchase shares might act. And the claimants having *bona fide* acted upon that statement, and suffered damage, can they recover from the company? I think they can, on the principle enunciated in *Freeman* v. *Cooke*, 2 Ex. 654, 18 L.J. Ex. 114. Suppose an action by the claimants against the company, asserting that the shares were the plaintiffs' and that the company refused to pay them the dividends and deprived them of the use of the shares, in effect an action of trover. The only plea would be that the plaintiffs were not the true owners of the shares, and there would be a replication by way of estoppel, that the company were estopped from saying that the plaintiffs were not the owners, because they had purchased on a statement of title made by the company, and intended by them to be acted upon; this would clearly amount to an estoppel within the rule defined in *Freeman* v. *Cooke*, 2 Ex. 654, 18 L.J. Ex. 114. The claimants, therefore, would be entitled to a verdict, and it follows that they are entitled as damages to the value of the shares at the time they were converted; that is, at the time when Miss Trittin interfered and claimed the shares.

BOSTON & ALBANY R.R. CO. *v.* RICHARDSON.

135 Mass. 473. 1883.

MORTON, C.J. This case, which is an action of contract with a count in tort, presents an important question, referred to, but not decided, in *Machinists' National Bank* v. *Field*, 126 Mass. 345.

In January, 1876, Mrs. Pratt owned five shares of the stock of the Boston and Albany Railroad Company, and held a certificate running in her name. Her son forged her name to a blank power of attorney, printed upon the back of the certificate, and delivered it to one Field, a broker. Field sold the shares to the defendants, and delivered to them the certificate with the forged signature thereon. The defendants presented it to the transfer clerk of the plaintiff by Brown, their clerk, who filled up the blanks so as to make it a power of attorney to Brown to transfer the shares to Richardson, Hill and Company, the defendants. Throughout, Brown was acting as the

agent and on behalf of the defendants. Thereupon the transfer clerk permitted Brown to transfer the shares upon the books of the corporation, and issued a new certificate to the defendants. Subsequently, and before the discovery of the forgery, the defendants sold the stock to a third person, and, at their request, the corporation issued a new certificate to the purchaser.

Upon these facts, it is clear that Mrs. Pratt never parted with her property in the shares, and therefore the plaintiff was obliged to procure five shares of its corporate stock, and issue a certificate to her, and also to pay her the dividends upon the five shares. *Pratt* v. *Taunton Copper Co.*, 123 Mass. 110, and cases cited. It is also settled that the corporation has no remedy against the person who purchased of the defendants, because, as to him, the corporation is estopped to deny its certificate issued to the defendants and transferred to the purchaser. *Machinists' National Bank* v. *Field, ubi supra*, and cases cited. The question in this case is whether it has a remedy against the person who presented a forged transfer or power of attorney, upon the faith of which it issued to such person a new certificate.

This question has never been directly decided in this Commonwealth, but the adjudged cases furnish analogies which aid us in its solution. It is familiar law that, in a sale of chattels, a warranty of title is implied, unless the circumstances are such as to give rise to a contrary presumption. *Shattuck* v. *Green*, 104 Mass. 42. The possession and offer to sell a chattel is held equivalent to an affirmation that the seller has title to it. This is founded upon the reason that men naturally understand that a seller who offers a chattel for sale owns it.

The same rule has been extended to the case of a sale of a promissory note. The seller impliedly warrants that the previous signatures are genuine. *Cabot Bank* v. *Morton*, 4 Gray, 156. *Merriam* v. *Wolcott*, 3 Allen, 258.

So it has been held that, if one, honestly believing himself to be authorized, acts as agent for another, and procures money or goods upon the credit of his supposed principal, and it turns out that he is not authorized, he is liable for the value of the money or goods. Chief Justice SHAW says: "If one falsely represents that he has an authority, by which another, relying on the representation, is misled, he is liable; and by acting as agent for another, when he is not, though he thinks he is, he tacitly and impliedly represents himself authorized without knowing the fact to be true, it is in the nature of a false warranty, and he is liable." *Jefts* v. *York*, 10 Cush. 392. The chief justice adds: "But in both cases his liability is founded on the ground of deceit, and the remedy is by action of tort." We do not understand him as intending to say that the only remedy is the technical action of deceit, and that a guilty knowledge must be proved. He used the

word "deceit" in the sense of tort. In numerous other cases, the remedy is said to be an action on the case for falsely assuming to be an agent. *Bartlett* v. *Tucker*, 104 Mass. 336, and cases cited. And in the recent case of *May* v. *Western Union Telegraph*, 112 Mass. 90, it was held that the proper remedy is not an action of deceit; but "it is an action in the nature of a false warranty against one acting as agent, who represents that he has authority when he has not. Whether such representation is made in terms, or tacitly and impliedly, he supposing but not knowing the fact to be true, he is liable to the person misled." We can see no good reason why an action of contract upon the implied warranty should not be maintained, in the same manner as it may be upon the implied warranty in the sale of chattels. *Randell* v. *Trimen*, 18 C.B. 786. *Richardson* v. *Williamson*, L.R. 6 Q.B. 276. *Baltzen* v. *Nicolay*, 53 N.Y. 467. But it is not necessary to discuss this, because in the case at bar there is both a count in contract and a count in tort in the nature of case, for falsely assuming to act as an agent.

Perhaps these considerations are sufficient to dispose of this case; but it seems to us that the result would be the same if Pratt had signed the transfer on the back of the certificate, instead of the power of attorney. The difference between the two modes of effecting a transfer is theoretical rather than practical. There is in either case a similar implied representation or warranty.

If one buys stock and takes a transfer, and presents the certificate to the corporation and demands a new one, he thereby impliedly represents that he is entitled to the new certificate. He demands it as his right; this implies that he is the owner and has a right to it. The corporation has the right to understand him as asserting this. It is not bound to question or investigate the genuineness of the transfer, and see if the purchaser has not been defrauded. When the purchaser presents his transfer and certificate, the transfer officer naturally understands that he claims the transfer to be valid, and to have a right to a certificate; he has the right to act as if this had been said in terms. And if, relying upon such tacit and implied representations, the corporation suffers a loss, the purchaser who misled it is liable.

See also *Clarkson Home* v. *Missouri Ry. Co.*, 182 N.Y. 47; *Oliver* v. *Bank of England*, [1902] 1 Ch. 610.

NEW ENGLAND TRUST CO. *v.* ABBOTT.

162 Mass. 148. 1894.

Morton, J. This is a bill brought by the plaintiff to compel the transfer to it by the defendant, as executor of the will of Josiah G. Abbott, of certain shares in the plaintiff corporation which were held by said Abbott at his decease, and which it is alleged he agreed, when the certificates were issued to him, should be appraised at his death by the directors, and transferred to the plaintiff at the appraisal, if the directors so elected. The bill also seeks to enjoin the defendant from prosecuting an action at law brought by him against the plaintiff to recover certain dividends upon said shares that have been declared by it.

The plaintiff was organized in 1869 under a special charter (St. 1869, c. 182), with a capital of five hundred thousand dollars, which was afterwards increased to a million. The terms of the alleged agreement are found in the by-laws, of which all that is now material is as follows: —

"Article 7. Any member of this corporation who shall be desirous of selling any of his shares, the executor or administrator of any member deceased, and the grantee or assignee of any shares sold on execution, shall cause such, their shares respectively, to be appraised by the directors, which it shall be their duty to do on request, and shall thereupon offer the same to them for the use of the corporation at such appraised value; and if said directors shall choose to take such shares for the use of the corporation, such member, executor, administrator, or assignee shall, upon the payment or tender to him of such appraised value thereof, and the dividends due thereon, transfer and assign such share or shares to said corporation; provided, however, the said directors shall not be obliged to take such shares at the appraised value aforesaid, unless they shall think it for the interests of the company; and if they shall not, within ten days after such shares are offered to them in writing, take the same, and pay such member, executor, administrator, or assignee therefor the price at which the same shall have been appraised, such member, executor, administrator, or assignee shall be at liberty to sell and dispose of the same shares to any person whatever.

"Article 8. The directors shall have power, and it shall be their duty, to sell and dispose of the shares which may be transferred as aforesaid to the corporation, whenever, in their judgment, it can be done with safety and advantage to the corporation; and in all sales made by the directors, under any of the aforesaid provisions, it shall be their duty to sell the shares to such persons as shall appear to them, from their situation and character, most likely to promote confidence in the stability of the institution; no greater number than

one hundred shares being assigned to any one person; nor, in the case of a person already a member, a greater number than will be sufficient to increase his previous number to one hundred shares."

These by-laws were adopted before any certificates of stock were issued. Afterwards, but before the capital was increased, Article 7 was duly amended by adding to it the following:

"It shall be the duty of such executor, administrator, grantee, or assignee to offer said shares for appraisal and to be taken by the corporation, if it shall so elect, whenever requested by the actuary or secretary, and no dividends or interest shall be paid or allowed after a failure to comply with such request; provided that such request shall not be made until after the payment of one dividend and the expiration of six months from the death of the owner or sale as aforesaid; but the offer may be made at any earlier period if the party shall prefer."

Every certificate contained on its face, as part of the certificate, the provision that "said shares are transferable only in person, or by attorney duly constituted, on the books of the company, and in the manner and upon the conditions expressed in the by-laws of the company printed upon the back of this certificate." On the backs of the certificates were printed By-laws 7 and 8. By-law 7 was printed as amended on the backs of those issued after the increase. There were also on the stubs from which the certificates were detached in the certificate-books two receipts given and signed by the defendant's testator at the time the two certificates were issued to him in the original and increased capital, which were each as follows: "Received the above certificate subject to the conditions and restrictions therein referred to, and to the by-laws of the company, to which I agree to conform."

The defendant contends that these by-laws are void. We have not found it necessary to consider that question, and we express no opinion upon it. We think that the case well may stand on the ground that the defendant's testator entered into an agreement with the plaintiff to do what the plaintiff now seeks to compel his executor to do.

It is manifest that a stockholder may make a contract with a corporation to do or not to do certain things in regard to his stock, or to waive certain rights, or to submit to certain restrictions respecting which the stockholders might have no power of compulsion over him. In *Adley* v. *Whitstable Co.*, 17 Ves. 315, 323, Lord ELDON says: "It has been frequently determined, that what may very well be made the subject of contract between the different interests in a partnership would not be good as a by-law; for instance, an agreement among the citizens of London, who have as extensive a power of making by-laws as any corporation, that they would not sell, except in the markets of London, would be good; yet it has been

declared by the legislature, that a by-law to that effect is bad." See also *Davis* v. *Second Universalist Meeting-House*, 8 Met. 321; *Bank of Attica* v. *Manufacturers & Traders' Bank*, 20 N.Y. 501, 505, 506; Cook, Stock & Stockholders, § 408.

In the present case the certificates were issued to the defendant's testator in consideration of the payment by him to the corporation of the amount due for the stock, and of the agreements with it on his part which they contained. By accepting them without objection, and by signing the receipts, he agreed to the conditions printed on the backs of the certificates. The fact that the conditions were contained in by-laws which may have been invalid as such, does not render his agreement void, if the contract was in substance one which the corporation had power to make.

We think that it had such power. It is held in this State that a corporation unless prohibited may purchase its own stock (*Dupee* v. *Boston Water Power Co.*, 114 Mass. 37), and we see nothing opposed to public policy in such an agreement as this with corporations like this. If honestly carried out by the directors it tends to secure a trustworthy body of stockholders, from which those having the care and management of the affairs of the corporation naturally would be selected. It certainly cannot be contrary to public policy that the managers of this and similar institutions should be persons of skill, who possess the confidence of the public, and the restraint upon alienation is no greater than is often agreed to.

In England it is not unusual to find in the deeds of settlement or articles of association under which corporations or joint-stock companies have been organized, and which correspond to the charter and by-laws here, provisions requiring the stockholder, in case he wishes to transfer his stock, to offer it to the directors, or to submit to them the name of the transferee for approval. *Bargate* v. *Shortridge*, 5 H.L. Cas. 297; *Poole* v. *Middleton*, 29 Beav. 646; *Chappell's case*, L.R. 6 Ch. 902; *Ex parte Penney*, L.R. 8 Ch. 446; *Moffatt* v. *Farquhar*, 7 Ch.D. 591. No objection seems to have been made to these provisions.

In this State the Legislature in numerous instances has provided in the charters of corporations like this, that the shares shall be transferable according to such rules and regulations as the stockholders shall establish, and not otherwise. It is hardly possible that the Legislature was ignorant of the construction which has been put upon the power thus conferred, and which in the case of the first corporation of the kind chartered in this Commonwealth, the Massachusetts Hospital Life Insurance Company (St. 1818, c. 180), was shown, it is said, by the adoption of by-laws from which those in this case were copied. It is true that this charter contains no provision in regard to by-laws, or to the transfer of shares. But the policy of the Legislature cannot be affected by such an omission, in view of the

fact that many of the charters since granted contain this provision.

NOTE. — A stockholder may transfer his stock to whomsoever he pleases, a by-law to the contrary notwithstanding. *McNulta* v. *Corn Belt Bank*, 164 Ill. 427, 447; *Bloede Co.* v. *Bloede*, 84 Md. 129; *Trust & Savings Co.* v. *Home Lumber Co.*, 118 Mo. 447; *Miller* v. *Farmers' Co.*, 78 Neb. 441; *Ireland* v. *Globe Milling Co.*, 21 R.I. 9; *In re Klaus*, 67 Wis. 401. See also *Third National Bank* v. *Buffalo German Ins. Co.*, 193 U.S. 581. See, *contra*, *Star Telephone Co.* v. *Longfellow;* 85 Kan. 353; *Nicholson* v. *Franklin Brewing Co.*, 82 Ohio, 94.

There is authority that the stockholder's right to transfer is unaffected, even if the declared restriction appears on the certificate of stock. *Finch* v. *MaCoupin Tel. Co.*, 146 Ill. App. 158; *Herring* v. *Ruskin Co.-op. Ass'n*, 52 S.W. (Tenn.) 327; *Feckheimer* v. *National Exchange Bank*, 79 Va. 80.

But restrictions on the right to transfer may be made by contract. See *Lindsay's Estate*, 210 Pa. 224; *Garrett* v. *Philadelphia Lawn Mower Co.*, 39 Pa. Sup. Ct. 78. And it is submitted that, if the stock certificate contains a statement of the restriction, this is a sufficient basis from which to predicate a contract to transfer the stock only in accordance with the restriction. For authorities in support of this proposition see *Jennings* v. *Bank of California*, 79 Cal. 323; *Barrett* v. *King*, 181 Mass. 476; *Farmers' Co.* v. *Laun*, 146 Wis. 252. See also *Bank* v. *Kerdolff*, 75 Mo. App. 297; *Stafford* v. *Produce Exchange Co.*, 61 Ohio St. 160.

As a share of stock is a chose in action against the corporation, and as every chose in action is created by contract, effect may be given to such restriction on the short ground that this restriction was inherent in the chose in action as and when created. See *Barrett* v. *King*, 181 Mass. 476; *Nicholson* v. *Franklin Brewing Co.*, 82 Ohio, 94; *Farmers' Co.* v. *Laun*, 146 Wis. 252; *Borland* v. *Steel Brothers & Co., Ltd.*, [1901] 1 Ch. 279.

The corporation's right must be exercised with fairness. *Adams* v. *Protective Union Co.*, 210 Mass. 172.

McDONALD *v.* DEWEY.

202 U.S. 510. 1906.

SECTION 5151 of the National Bank Act provides: "The shareholders of every national banking association shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts, and engagements of such association, to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in such shares."

The defendant transferred some of his shares in a national bank at a time when the bank was insolvent, and when he knew or ought to have known the fact. The Circuit Court of Appeals held there could be no recovery against the defendant without proof of the additional fact that the several transferees were likewise insolvent.

Mr. Justice Brown. That the transfer of stock in corporations, even when in failing circumstances, should not be unduly impeded, is essential not only to the prosperity of such corporations and the value of their stock, but to the interest of stockholders who may desire for legitimate reasons to change their investments or to raise money for debts incurred outside the business of such corporation. *Bank* v. *Lanier*, 11 Wall. 369, 377. At the same time the frequency with which such transfers are made for the purpose of evading the double liability imposed by the National Banking Act, has given rise to a large amount of litigation turning upon their legality. In this connection certain propositions have been laid down by so many courts and in so many cases that they may be regarded as fundamental principles of law applicable to all cases of this character.

(1) That a party, who by way of pledge or collateral security for a loan of money, accepts stock of a national bank and puts his name on the registry as owner, incurs an immediate liability as a stockholder, and cannot relieve himself therefrom by making a colorable transfer of his stock to another person for his own benefit, as was done by the sale to Jewett in this case. *National Bank* v. *Case*, 99 U.S. 628; *Marcy* v. *Clark*, 17 Mass. 329; *Nathan* v. *Whitlock*, 9 Paige, 152; Cook on Stockholders, § 263.

(2) The same result follows if the stockholder, knowing, or having good reason to know, the insolvency of the bank, colludes with an irresponsible person with design to substitute the latter in his place, and thus escape individual liability, and transfers his stock to such person. It is immaterial in such case that he may be able to show a full or partial consideration for the transfer as between himself and the transferee. *Bowden* v. *Johnson*, 107 U.S. 251.

Upon the other hand, in *Whitney* v. *Butler*, 118 U.S. 655, certain stockholders employed an auctioneer to sell their shares at public auction. They were bidden in by a purchaser who paid the auctioneer for them and received from him the certificate of stock with a power of attorney to transfer the same in blank. The auctioneer paid the money to the original owner of stock, but no formal transfer was made on the books of the bank. Shortly afterwards the bank became insolvent and went into the hands of a receiver, who made an assessment upon the original stockholders. We held that the responsibility of the stockholders ceased upon the surrender of the certificate to the bank, and the delivery to its president of a power of attorney to transfer the stock on the books of the bank. The controlling considerations were the good faith of the stockholders in making the sale,

believing the bank to be solvent, and the fact that they had done all that they could reasonably be expected to do to make a valid sale of the stock and a transfer of the certificate on the stock register.

Under the English law a shareholder may transfer his shares to an irresponsible party for a nominal consideration, though the sole purpose of the transfer be to escape liability, provided the transfer be out and out, and not merely colorable or collusive, with a secret trust attached. Under such circumstances the person making the transfer is released from liability, both as to corporate creditors and the other shareholders. Cook on Stockholders, § 266; 2 Morawetz on Private Corporations, § 859.

The law is quite different in this country. At the same time the original stockholder cannot be held liable, unless the bank were practically insolvent at the time the transfer was made, and its condition was known or ought to have been known to the stockholder making the transfer. If the bank were in fact solvent and able to pay its debts as they matured when the transfer was made, the creditors having ample security in the solvency of the bank, have no special interest in knowing who the stockholders are, since their only recourse to them would be in the remote contingency of the insolvency of the bank. The transferrer can only be held liable if the bank be insolvent, and such insolvency be known, or ought to have been known, to him from his relations to the bank, since the transfer is *prima facie* valid, and shifts to the transferee the burden of the responsibility, which can be laid upon the original stockholder only in case of bad faith, or evidence of a purpose to evade liability.

This bad faith may be shown by the fact that the bank was known to him to be insolvent; but notwithstanding this the transfer would be valid if made to a person of known financial responsibility, since the creditors could not suffer by the substitution of one solvent stockholder in place of another. The Court of Appeals, however, went further and held that the transfer would be valid unless made to an irresponsible person unable to respond to an assessment, whose financial condition was known, or ought to have been known, to him.

[After reviewing the authorities.] We think it a proper deduction from the prior cases, and such we hold to be the law, that the gist of the liability is the fraud implied in selling, with notice of the insolvency of the bank and with intent to evade the double liability imposed upon the stockholder by the National Banking Act. In short, the question of liability is largely determinable by the presence or absence of an intent to evade liability. The fact that the sale was made to an insolvent buyer is doubtless additional evidence of the original fraudulent intent, but would not be in itself sufficient to constitute fraud without notice of the insolvency of the bank. The stockholder is not deprived of his right to sell his stock by the fact that the sale is made to an insolvent person, unless it be made with

knowledge of the insolvency of the bank. This was practically the ruling in *Earle* v. *Carson*, in which we held that a *bona fide* sale would not be void, though the vendee were insolvent, if the fact of such insolvency were at the time unknown to the seller. The case of *Earle* v. *Carson*, so far from lending countenance to the argument of the appellees, bears strongly in the opposite direction.

The solvency of the vendee, however, is pertinent in showing that no damage could have resulted to the creditors of the bank by the transfer. Though not a necessary part of the plaintiff's case, it may be a complete defense, if it be shown that the sale, however fraudulent, was made to a vendee who was as able to respond to the double liability as was the vendor. The proposition that the executors are not responsible because the sales were made to solvent vendees, being defensive in its character, the burden of proof was upon them. In this particular the case is not unlike that of an ordinary action upon a contract, where the plaintiff relies upon the contract and the breach, and sues for such damages as may be reasonably supposed to follow therefrom. But it may be shown in defense that no damages really resulted, as, for instance, in an action for services, that plaintiff might have obtained other employment at the same wages, or, in an action for a failure to deliver goods, that plaintiff might have gone into the market and purchased other goods at the same price at which the defendant had agreed to sell them. In such case defendant assumes the burden of proving that no damage in fact resulted. The argument in this case really is that the receiver was bound to show, not only that Dewey was guilty of fraud, but that damages necessarily resulted and that he knew that fact. The reply is that the fraud was consummated by the sale of the stock of a bank known to be insolvent, with intent to evade liability, and that the fraud is not less though the transferees happened to be solvent, but that their solvency may be proved to rebut the presumption that injury resulted to the creditors from the transfers.

While there is no express finding of the Court of Appeals (though there was in the Circuit Court) that Dewey knew, or should have known, of the insolvency of the bank at the time of the transfer, and that the transfer was made with the intent to evade his double liability as stockholder, the decree of both courts is based upon this assumption; and as stated in the dissenting opinion "that the final suspension of the bank, though it occurred two years and five months after Dewey's transfer of stock, is traceable, in the line of cause and effect, to the insolvency of the bank at the time of the transfer." We do not understand these facts to be seriously disputed.

NOTE. — For a statement of the English law, see *In re Discoverers Finance Corporation, Ltd.*, [1910] 1 Ch. 312.

SECTION 3.

VOTING TRUSTS.

LUTHY v. REAM.

110 N.E. (Ill.) 373. 1915.

THE complainants sought the cancellation of the voting trust agreement set forth in the opinion.

DUNN, J. The Peru Plow & Wheel Company is a corporation organized under the laws of Illinois, having a capital stock of $400,000, engaged in the manufacture of plows, metal wheels, and farm implements. The complainants are the owners of 2,027 of the 4,000 shares of its stock; Thomas Cahill being the owner of 70 shares purchased in November, 1912. In September, 1912, 41 of the stockholders, owning 2,001 shares of the stock, entered into the trust agreement in controversy. After reciting that the stockholders deemed it to their interest that all of their stock should be voted as a unit upon all questions affecting the business and management of the company, and that Henry Ream had consented to hold and vote such stock on behalf of the stockholders, the agreement provided: —

"That for a valuable consideration, the receipt whereof is hereby acknowledged, and in further consideration of the mutual covenants and agreements expressed in this agreement, the stockholders hereby assign, convey, and transfer unto the trustee above named the number of shares of stock of the Peru Plow & Wheel Company, a corporation of the state of Illinois, as set opposite their respective names, to be held in trust by the said trustee for the respective stockholders by whom it is severally assigned, their personal representatives and assigns, upon the following terms and conditions:

"(1) The said trustee shall hold, control, and vote said stock as if he was the owner of all of said stock.

"(2) Said trustee shall determine how said stock shall be voted upon any question, at any time and every meeting of the stockholders.

"(3) All of said stock so held by the trustees shall be voted as a unit.

"(4) At all elections of directors of the Peru Plow & Wheel Company said trustee shall nominate three directors to be voted for at such election, and said trustee shall vote all said stock held by him as a unit for each and all of the directors so nominated by him.

"(5) A vacancy in the office of trustee, as herein provided for, shall be filled in the following manner, viz.: In the event of the death, res-

ignation, or removal, for any cause whatever, of said trustee herein, the vacancy in the office of trustee shall be filled by a majority in amount of the then holders of the stock now owned by the following stockholders [here appear the names of the signers of the agreement], parties to this agreement, as appears set opposite their respective names subscribed hereto.

"(6) Said trustee shall prepare, and issue to the stockholders, certificates showing the amount of stock held on behalf of each stockholder, respectively, and the stock so held may be divided and transferred in like manner as if it had not been assigned in trust, subject to the rights and powers of the trustee under this agreement. But no such assignment or transfer of stock shall be effective for any purpose until surrender of the certificate issued by said trustee and the issue of a new certificate to the purchaser or assignee thereof.

"(7) No fees shall be charged by such trustee herein designated for any services performed in connection with the trust hereby created.

"(8) Said trustee shall collect and receive all dividends on the stock transferred to and held by him, and shall immediately pay over the same to the holders of trust certificates representing such stock as their respective interests appear. The trustee shall not demand or receive any compensation for receiving and paying over such dividends.

"(9) The rights, duties, and powers hereby conferred upon said trustee shall expire and wholly cease on the 1st day of September, A.D. 1922, and the trustee shall at said time assign and transfer to the persons who then hold trustee's certificates evidencing their ownership of shares of stock the amount of stock to which each holder thereof is shown by his trustee's certificate to be entitled.

"(10) Said trustee hereby accepts the trust hereby created by the above and foregoing instrument, and hereby undertakes to hold, own, and vote said stock as therein provided, and to retransfer the same on the 1st day of September, A.D. 1922, to the holders of trustee's certificates evidencing their right to receive the same. Said trustee further undertakes at all times to vote the said stock by himself or by proxy, and exercise his powers as trustee in such manner as he shall deem to be for the best interests of the stockholders of the Peru Plow & Wheel Company. Said trustee further undertakes to accept additional assignments of stock from any and all stockholders of the Peru Plow & Wheel Company, and to permit any stockholder thereof to become a subscriber to this agreement. It is expressly understood and agreed that Henry Ream, trustee herein referred to, shall not be liable, either directly or indirectly, to any person, firm, or corporation for any loss or damage whatever occurring on account of the trusteeship, or from any act done by the said trustee in connection with the duties and trusts herein imposed upon him."

The certificates of stock of the stockholders signing the agreement were canceled, and two certificates, for 2,001 shares in the aggregate, were issued to Ream as trustee. He issued to each stockholder a trustee's certificate stating that the stockholder to whom it was issued was the owner of a certain number of shares of the capital stock of the Peru Plow & Wheel Company held by him as trustee, subject and pursuant to the terms, conditions, and stipulations of a certain agreement between him, as trustee, and certain stockholders of the said Peru Plow & Wheel Company joining in the said agreement of date September 4, 1912, a copy of which agreement was on file with the trustee, and reference was had to it as to all the terms, conditions, and requirements of the trust. The certificates were stated to be transferable only on the books of the trustee by the owner thereof in person or by attorney, upon its surrender properly indorsed, when like new certificates would be issued to the proper owner of record. On the back of each certificate was a form for its assignment.

Among the stockholders signing the agreement were Kate Cahill, John D. Cahill, and Cornelius J. Cahill, who together owned 70 shares of stock. They sold their shares to the appellant Thomas Cahill, and assigned to him their trust certificate. He presented the certificate so assigned to him to Henry Ream, who was president of the corporation, and demanded that a certificate should be issued to him by the president and secretary of the corporation for 70 shares of its capital stock; but the said Henry Ream refused to issue such certificate, and stated that said 70 shares of stock were included in the trust agreement, and that he could not and would not issue a certificate for them to Thomas Cahill for that reason. Thomas Cahill thereupon notified him that as the owner of 70 shares he withdrew the same from the said trust agreement and would no longer be bound thereby, and demanded that a certificate be issued to him free from any restraint, obligation, or condition under said trust agreement; but said Henry Ream refused to issue such certificate.

The effect of the agreement was to place the legal title of the majority of the stock in Henry Ream, who was given the power to vote the stock for 10 years upon all questions and at every meeting of the stockholders according to his own discretion, uncontrolled by the stockholders in any way. He then owned 37 shares of stock, and thus the entire control of the corporation was conferred upon the owner of less than 1 per cent. of the stock, with no power in the owners of the remaining 99 per cent. to interfere in any way. We have held that it is legitimate for the owners of a majority of the stock of a corporation to combine for the purpose of controlling the corporation. *Faulds* v. *Yates*, 57 Ill. 416, 11 Am. Rep. 24; *Venner* v. *Chicago City Railway Co.*, 258 Ill. 523, 101 N.E. 949. In this case, however, the agreement goes much farther than any case which has heretofore arisen in this

court. The voting power of the stock is absolutely separated from its ownership for a term of years, so that the real owners of the property are during that time entirely divested of its management and control, or of any participation therein. Our law contemplates that corporations shall be controlled by a majority of the stockholders, acting through directors elected by them in person or by proxy, and it has been held that a by-law of a corporation which authorizes bondholders to vote for directors at stockholders' meetings is in violation of both the constitutional and statutory provisions requiring directors to be elected by a majority of the shares of stock of the corporation. *Durkee* v. *People,* 155 Ill. 354, 40 N.E. 626, 46 Am. St. Rep. 340. The power to vote for directors can be exercised only by stockholders in person or by proxy, and they cannot be deprived or deprive themselves of this power. Stockholders cannot evade the duty imposed upon them by law of using their power as stockholders for the welfare of the corporation and the general interest of its stockholders. A stockholder may refuse to exercise his right to vote and participate in stockholders' meetings, but he cannot deprive himself of the power to do so. [The court quoted from the *Shepaug Voting Trust Cases,* 60 Conn. 579.]

A stockholder may ordinarily withdraw from a combination to control the majority of the stock of a corporation, and a contract not to transfer his shares to the opposition or vote against the combination, although it is expressly agreed that the contract shall be irrevocable. 1 Beach on Corporations, § 305. In § 306 of the same work it is said: "On general principles, the right to vote on stock cannot be separated from the ownership in such sense that the elective franchise shall be in one man and the entire beneficial interest in another, nor to any extent unless the circumstances take the case out of the general rule. It matters not that the end is beneficial and the motive good, because it is not always possible to ascertain objects and motives, and if such a severance were permissible it might be abused."

While the pooling of stock for the purpose of electing directors and officers and controlling the management and business of the corporation is not necessarily illegal, an agreement the purpose and effect of which are to permit the affairs of the corporation to be managed by the determination of persons other than its stockholders or by a minority of its own stockholders is invalid. *Shepaug Voting Trust Cases, supra; Kreissl* v. *Distilling Co. of America,* 61 N.J. Eq. 5, 47 Atl. 471; *White* v. *Thomas Inflatable Tire Co.,* 52 N.J. Eq. 178, 28 Atl. 75; *Warren* v. *Pim,* 66 N.J. Eq. 353, 59 Atl. 773; *Bache* v. *Central Leather Co.,* 78 N.J. Eq. 484, 81 Atl. 571; *Morel* v. *Hoge,* 130 Ga. 625, 61 S.E. 487, 16 L.R.A. (N.S.) 1136, 14 Ann. Cas. 935; *Harvey* v. *Linville Improvement Co.,* 118 N.C. 693, 24 S.E. 489, 32 L.R.A. 265, 54 Am. St. Rep. 749; *Bridgers* v. *First Nat. Bank of Tarboro,* 152 N.C.

293, 67 S.E. 770, 31 L.R.A. (N.S.) 1199. The principle to be deduced from these cases is that the holders of the majority of the shares of stock in a corporation may control its management, and every person who becomes an owner of stock has a right to believe that the corporation will, and to insist that it shall, be managed by the majority; that the power to vote is inherently attached to and inseparable from the real ownership of each share, and can only be delegated by proxy, with power of revocation; that each stockholder must be free to cast his vote, whether by himself or by proxy, for the best interest of the corporation; and that each stockholder has the right to demand that every other stockholder, if he desires to do so, shall have the right to exercise at each annual meeting his own judgment as to the best interest of all the stockholders, untrammeled by dictation, and unfettered by the obligation of any contract.

We held in *Venner* v. *Chicago City Railway Co.*, *supra*, that the election of directors under the provisions of the trust agreement there involved, in the manner therein provided, was really an election by the stockholders through their proxies, and so was not in violation of any constitutional or statutory provisions. There is no such thing as an irrevocable proxy to vote stock not coupled with any interest in the stock itself other than the right to vote it. A proxy, though stated to be irrevocable, may be revoked at any time. 1 Cook on Corporations, § 610. This contract gave to Henry Ream alone the power for ten years to elect three of the five directors of the corporation and to formulate and determine its policy, unrestrained and uninfluenced by all the other stockholders or any of them. The surrender of their duties by the stockholders is complete, and the majority have no power to direct the trustee; for he alone is to determine how the stock shall be voted, and to vote it, upon any question, at any time and every meeting of the stockholders. He no longer represents the majority of the stock, for 70 shares have been sold to the complainant Cahill, who has the entire beneficial interest therein. Other shares may be sold, so that before the expiration of the trust the trustee, who originally represented a majority of the stock, but now represents only a minority, may represent only his own 37 shares, and yet, if the trust agreement is to be enforced, have absolute management and control of the corporation.

In *Smith* v. *San Francisco & North Pacific Railroad Co.*, 115 Cal. 584, 47 Pac. 582, 35 L.R.A. 309, 56 Am. St. Rep. 119, it was held that an agreement by several purchasers of stock in a corporation to vote it as a unit for five years, in accordance with the decision of the majority, is binding upon the parties and irrevocable. In *Carnegie Trust Co.* v. *Security Life Ins. Co. of America*, 111 Va. 1, 68 S.E. 412, 31 L.R.A. (N.S.) 1186, 21 Ann. Cas. 1287, the Supreme Court of Virginia held that an agreement among stockholders to place their stock in the hands of trustees for 25 years, to enable the trustees to manage

the corporation, constitute a valid trust. These cases are inconsistent with the views which we have expressed and the cases cited in support of them, but in our judgment the latter cases state the true rule.

Although Thomas Cahill purchased his stock with notice of the agreement, that agreement was not binding upon him or his vendors if he or they wished to withdraw from it, and upon his demand for a certificate of stock he was entitled to receive it.

MOBILE & OHIO R.R. CO. *v.* NICHOLAS.

98 Ala. 92. 1893.

BILL in equity by stockholder in Mobile & Ohio R.R. Co. against the railroad company, the Farmers' Loan & Trust Co., *et al.*

In 1876, the railroad company was in the hands of a receiver; decrees of foreclosure had been rendered in suits on mortgages; and its total indebtedness largely exceeded the value of the entire railroad property. An arrangement was made between the creditors and the company whereby the creditors accepted debentures in lieu of their original evidences of debt; and the great majority of the stockholders, in effect, conferred upon a trustee irrevocable power to vote upon the shares so long as any of the debentures should be outstanding. The shareholders assigned their stock to the committee of reorganization; the committee gave the Farmers' Loan & Trust Company an irrevocable power of attorney to vote upon the stock so long as any of the debentures should be outstanding. The shareholders who had thus assigned their stock to the committee received in exchange new certificates entitling them to all the rights and privileges which pertain to the ownership of the said shares, saving and excepting that such ownership is subject to the power heretofore granted by the owners of said shares to the Farmers' Loan & Trust Company, in trust for the security of the debentures, to vote upon said shares.

Under the foregoing adjustment, all the creditors, except those secured by newly issued first mortgage bonds, accepted the debentures provided for, in lieu of their former evidence of debt; the foreclosure decrees were assigned to the Farmers' Trust Company; the receiver, under the orders of the court, turned the property over to the railroad company; and the corporation resumed its control and management of its property and business.

In 1892, the plaintiffs denied the authority of the Trust Company, under the power of attorney held by it to vote their stock, and claimed for themselves the right to vote their own stock. The right of plaintiffs to vote at the stockholders' meeting was denied. Thereupon plaintiffs filed the present bill; praying, among other things, that the Farmers' Loan & Trust Company be enjoined from voting

on the stock under the power of attorney; and that the railroad company be enjoined from refusing to accept the votes of plaintiffs and of other stockholders.

A preliminary injunction was granted. The defendants moved to dismiss the bill for want of equity, and to dissolve the injunction. The Chancellor overruled the motions. From his decrees an appeal was taken.

COLEMAN, J. The facts stated in the bill show, that by the reorganization and compromise of 1876, perfected in 1879, the voting power was severed from the stockholder, and until the payment of the debentures, irrevocably vested in the Farmers' Trust Company and the debenture holders. It is contended for complainants that the agreement was, and "is void *per se*," because 1st: "It contravenes the language of the charter of the railroad company; and 2d, because it is against public policy."

The charter expressly provides, "Each share shall entitle the holder thereof to one vote, which vote may be given by said stockholder in person, or by lawful proxy."

So far, then, as the right to vote by proxy is questioned, the charter expressly grants the power, and the legislature has thus declared that it is not unlawful, *per se*, to separate the voting power from the stockholder, so far as the appointment of a proxy may be considered a severance of the voting power. Where a proxy is duly constituted, and the power of the appointment is without limitation, a vote cast by the proxy binds the stockholder, whether exercised in behalf of his interest or not, to the same extent as if the vote had been cast by the stockholder in person. We do not hold that a power of attorney, absolute in its terms, will authorize the agent or proxy, to effect contracts, or legalize acts, outside of the scope of his authority, or contrary to law or public policy, neither could the stockholder in person by his vote effectuate such a result. The invalidity of acts of this character by a proxy, rightly understood, is not made to rest upon the ground that there has been a separation of the voting power from the stockholders, but because of the unlawful purpose for which the proxy was appointed, or the unlawful end, attempted to be effected by the exercise of the voting power. The distinction should be kept in view. . . .

Take the case of *Hafer* v. *New York, Lake Erie & Western R.R. Co.*, 14 Weekly Law Bulletin, p. 68. The case is thus stated: "A controlling interest in the stock of the Cincinnati, Hamilton, and Dayton Railroad Company was bought up in 1882, and placed in the name of H. I. Jewett, who was Vice-President of the New York, Lake Erie, and Western Railway Company, under the agreement that he should give irrevocable proxy to such persons as the Erie should appoint to vote on the stock; that his stock certificates should be left in the hands of trustees, and that they should issue to the respective owners

of the stock trust, or pool certificates for amounts equal to their respective equitable interest. On all stock thus pooled, the Erie agreed to guarantee a certain dividend."

The court declared the contract void "both on the ground that the power is denied to one corporation thus to acquire control of another, and that the stockholder can not barter away the right to vote upon his stock." True the opinion declares as an independent proposition, "that the stockholder can not barter away the right to vote upon his stock," and yet it is shown, by the facts of the case and the opinion, that the purpose to be effected by the barter of the right to vote, to wit, the placing "of an Ohio corporation into the hands of a New York corporation," the enabling "one corporation to acquire control over another" was illegal. Speaking of the facts of the case the opinion proceeds as follows: "It is obvious that the rule as to executed contracts can not be applied to the plaintiff for any such reason as that last mentioned, *for he was not a party to the contract.* There are other cases wherein special circumstances made it imperative, as a matter of good faith, that the contract should not be interfered with, and others, when the protection of interests acquired by innocent parties caused the court to refrain." There is no rule of law which requires contracts to be upheld which are void as against public policy, in order to preserve "good faith" or "innocent parties." The rule of estoppel is often applied to prevent undue advantage by one person over another, but the rule does not extend to contracts which are void because contravening public policy. Considering the opinion as an entirety, we do not regard it as authority to the proposition, that an agreement which provides for a separation of the right to vote from the holder of the stock is "*per se*," at all times and under all circumstances contrary to public policy and void. We have examined case after case and find generally that the agreements declared void by the courts, where the power to vote was separated from the stockholder and vested in third persons, were under circumstances which showed that the purpose to be accomplished was unlawful, such as the courts would not sanction if the principal had voted and not a proxy; and in cases of a mere dry trust, it is held that the stockholder might revoke a power of attorney in form irrevocable. The doctrine as to dry trust does not arise in this case. . . . If there were no precedents, upon principle, we would hold that in determining the validity of an agreement, which provides for the vesting of the voting power in a person other than the stockholder, regard should be had to the condition of the parties, the purpose to be accomplished, the consideration of the undertaking, interests which have been surrendered, rights acquired, and the consequences to result. The law does not make contracts for parties, neither will it annul them except to preserve its own majesty, and to conserve the greater interest of the public. Let us examine the conditions of the

parties, the purpose in view and effect of the agreement of 1876, consummated in 1879, the consideration and interest surrendered and rights acquired by the readjustment, and issue of the debentures, the position of the complainants thereto, and the results of holding that reorganization, *per se*, void.

The complainants belong to the class known as "Assenting Stockholders." They surrendered their stock to the committee of reorganization in order that the power of attorney, executed to the trust company by the committee of reorganization, might be executed, and that the debentures should be issued to the creditors of the railroad corporation. The certificates of stock held by them show, upon their face, that they are subject to the power of attorney and to the rights of the debenture-holders. At the time the plan of adjustment was agreed upon the railroad company was in the hands of a receiver. Decrees of foreclosure rendered against the company. The indebtedness far exceeded the value of the railroad company's property. The execution of the decrees of foreclosure, by a sale of the property, and the prosecutions of the admitted claims against the railroad company, would necessarily have transferred the property to other parties and wiped out every vestige of present available interest or right of the stockholder, or hope of future profit. The creditors held the vantage ground, and in law their rights and interest were paramount to the stockholders. The latter might accept propositions but were in no position to dictate terms. These were the circumstances under which the settlement and agreement was made. Stated in short, the compromise and settlement led to the issue of the debentures to the creditors in lieu of their original evidences of debt, and a mortgage upon certain property to secure them, a plan for a sinking fund for their benefit, and the right and privilege under an irrevocable power of attorney to vote the stock *until the debentures were paid.* The power of attorney was not in perpetuity, or absolute, but only until the debentures were paid, and a fair construction under the circumstances required that the voting power should be used fairly and honestly to this end, or as stated in the agreement itself, "for the uses and purposes declared in said memorandum, and until the same are fully accomplished." In consideration therefor the decrees of foreclosure, at first suspended, were transferred to the trust company, creditors surrendered their claims and accepted in lieu thereof the debentures, the receiver under the orders of the court restored the property to the Mobile & Ohio Railroad Company, which resumed management and control of its property and affairs, and the stock preserved to the stockholder.

To this agreement over forty-five thousand out of a total of about fifty-three thousand of shares of stock assented, and among those which assented were complainants. The creditors had the right to accept debentures for their debts. The agreement continued in ex-

istence the corporation and preserved to the stockholders their stock. It did not violate the charter of the railroad corporation. The purpose was legal, the means used did not contravene any statute of the State or principle of public policy, and was within the scope of the power of the contracting parties. Good faith on the part of the assenting stockholders, whose interests were thus preserved, and to those who accepted the debentures in lieu of other evidences of debt and securities, and to those who have since purchased them upon the faith of the plan of compromise demand that the terms of the contract be fulfilled.

BRIGHTMAN *v.* BATES.

175 Mass. 105. 1900.

Holmes, C.J. These are actions upon a covenant executed by the defendants. The covenant recites that 1,360 shares of the stock of the Union Street Railway Company in New Bedford have been or are about to be purchased by a syndicate, under an agreement of September 4, 1894, that the plaintiff has been largely instrumental in organizing the syndicate, and that "he considers that for his services therein in case the syndicate is formed, and the aforesaid shares purchased, he should receive for his compensation" a certain amount of stock. These recitals are followed by several covenants on the part of the defendants and one other to give the plaintiff, in stock of the company at $169 a share, a commission of $4 a share "upon the number of shares of said stock we sell to said syndicate, less the number of shares we have severally subscribed as members of said syndicate," and certain other deductions, in case the compensation was not got from the syndicate. The judge before whom the case was tried found for the plaintiff, and the case is here upon a report of requests for rulings which in various forms raise the question whether such a finding can be justified in law. . . .

The syndicate referred to was formed under another written agreement, whereby the subscribers recite their desire to become members of it to the end that control of the railway company and advantage to them may be gained, agree to take the shares set against their names at $169 a share, and further agree after the purchase to enter into a pooling contract whereby all the syndicate stock "shall be voted at each annual meeting for a period of not less than three years, for such board of directors as shall be named" by a committee of five of the subscribers, with power to a majority of them to fill any vacancy in the committee. It is said that this agreement was illegal, and that the covenant sued upon was so directly aimed at helping to bring the unlawful arrangement about that it must fall with the

other. *Barnes* v. *Smith*, 159 Mass. 344, 347; *Gibbs* v. *Consolidated Gas Co.*, 130 U.S. 396.

Without deciding whether, if the covenant was dependent upon the rendering of further services, it was so closely connected with the syndicate agreement as to fall if the latter cannot be sustained, we pass to the question whether the latter agreement is unlawful on its face, bearing in mind that unless it is unlawful on its face it has the advantage of a finding in favor of the plaintiff. In dealing with this question it does not need to be said that combination of common interests is necessary, and constantly is taking place. It is as legitimate for a majority of stockholders to combine as for other people. The fact that they expect "gain and advantage" — in the words of the syndicate agreement — to accrue to them, does not make the combination unlawful. That expectation and intent would have that effect only if the gain was to be at the expense of the corporation, or in some way was intended to work a wrong to the other stockholders. No such intent appears, and although it is impossible not to view such an arrangement with suspicion, it is also impossible to let suspicion take the place of proof.

The only serious ground of objection is the agreement that the stock "shall be voted at each annual meeting" for three years, for a board of directors named by the committee. It is suggested that this was an unlawful attempt by the contracting parties to deprive themselves in advance of their deliberative power and duty as stockholders, and to submit themselves to the dictation of five men who in the future might not be even members of the corporation. Perhaps the notion upon which these suggestions are founded has been pressed somewhat further than would be warranted by more far-seeing views, but we have no occasion to discuss it in this broad form. The question before us is not whether it would be possible to carry out the contract in a way which would have made the contract bad if specified in it, but whether it was impossible to carry out the contract in a way which might lawfully have been specified in advance. We put the question in this form because there is no doubt that the subscribers might actually have done the things stipulated without giving any one a right to complain. That is to say, they might have held their stock and voted by previous understanding according to the advice of the committee, as long as they chose. The question is what they might contract to do; for this is supposed to be a case where a contract to do lawful acts is unlawful.

The syndicate agreement does not specify how it is to be carried out. It contemplates the making of another contract. As the later contract is to be a pooling contract, it was possible, if not probable, that one element of the arrangement would be that the title to the stock should be given to a trustee, and this happened in fact. During the three years the stock seems to have been held by a bank. The

stock was transferred to it, and was not transferred to the members of the syndicate. But it would have been possible, consistently with the terms of the syndicate agreement, that the committee who were to name the board of directors themselves should be the trustees. In that case the trustees, of course, would have voted on the stock. They, not their *cestuis que trust*, would have been the stockholders for the time being. We know nothing in the policy of our law to prevent a majority of stockholders from transferring their stock to a trustee with unrestricted power to vote upon it. *Brown* v. *Pacific Mail Steamship Co.*, 5 Blatchf. 525, 527. See *Greene* v. *Nash*, 85 Maine, 148.

Supposing that the committee had been trustees, what would the syndicate agreement have amounted to then? Merely an agreement by each of the trustees to vote as they should jointly agree to vote, and an agreement by the subscribers not to demand back their shares for three years. The latter term certainly is not illegal, whether valid or not. A stockholder has a right to put his shares in trust, whatever his motive. If the trust is an active one he cannot terminate it at will, and the attempt to cut himself off by contract, instead of by the imposition of duties, from ending it, certainly is not enough to poison the covenant with the plaintiff. See *Williams* v. *Montgomery*, 148 N.Y. 519, 525. It might be held that the duty of voting incident to the legal title made such a trust an active one in all cases. As to the arrangement for the trustees uniting to elect their candidates, the decisions of other States show that such arrangements have been upheld, and we do not think that it needs argument to prove that they are lawful. If stockholders want to make their power felt, they must unite. There is no reason why a majority should not agree to keep together. *Faulds* v. *Yates*, 57 Ill. 416; *Smith* v. *San Francisco & North Pacific Railway*, 115 Cal. 584; *Havemeyer* v. *Havemeyer*, 11 Jones and Spen. 506, 512, 513, affirmed, according to Beach, Corporations, § 304, n. 6, and *Fisher* v. *Bush*, 35 Hun, 641, in 86 N.Y. 618. See *Brown* v. *Pacific Mail Steamship Co.*, 5 Blatchf. 525, 527.

We have considered such decisions elsewhere as have been called to our attention or found by us. Few of them are by courts of final resort. Nothing that we have found in them satisfies us that the judge below was not warranted in finding for the plaintiff.

Judgment for the plaintiff.

NOTE. — See also *Smith* v. *San Francisco Ry. Co.*, 115 Cal. 584; *Greene* v. *Nash*, 85 Me. 148; *Bowditch* v. *Jackson Co.*, 76 N.H. 351; *Boyer* v. *Nesbitt*, 227 Pa. 398 (*cf. Commonwealth* v. *Roydhouse*, 233 Pa. 234); *Thompson-Starrett Co.* v. *Ellis Granite Co.*, 86 Vt. 282; *Carnegie Trust Co.* v. *Security Insurance Co.*, 111 Va. 1; *Winsor* v. *Commonwealth Coal Co.*, 63 Wash. 62.

New York Consolidated Laws, 1909, chapter 28, section 25 (p. 1327), authorizes voting trusts on the terms there stated, one of which is that "every other stockholder, upon his request therefor, may, by a like agreement in writing, also transfer his stock to the same person or persons and thereupon may participate in the terms, conditions and privileges of such agreement."

CHAPTER III.

CREDITORS.[1]

SAWYER v. HOAG.

17 Wall. (U.S.) 610. 1873.

Appeal from the U.S. Circuit Court for the Northern District of Illinois.

Bill in equity by Sawyer against Hoag, assignee of the Lumberman's Insurance Company of Chicago, to enforce an alleged right of set-off. In 1865 the company was incorporated and authorized to begin business on a capital of $100,000, of which not less than one-tenth should be paid in, the residue to be secured. The directors stated to most of those invited to subscribe that only 15 per cent would be required to be paid down in cash, and that the remaining 85 per cent would be lent back to the subscriber, and a note taken therefor payable in five years, with seven per cent interest, secured by collateral. In 1865 Sawyer, upon the above understanding, subscribed for fifty shares of the par value of $100 each. He gave his check to the company for $5000, and his note payable to it in five years for $4250 (85 per cent of the par value of the stock) with interest; delivered to the company satisfactory collateral security; and received from the company a check for $4250, by way of, and as for a loan thereof, from the company. He also gave the company authority to sell the securities in case of default in payment of the note or the interest thereon.

Subsequently Sawyer took up the above note, and gave in substitution another note.

The original transaction was treated by the company and by Sawyer as a loan by the company to him, and his stock was treated as fully paid for. At various times after the giving of the note, the company reported to the authorities of the State of Illinois and of other States that its capital stock was fully paid.

In October, 1871, the company was rendered insolvent by the great fire in Chicago.

In January, 1872, Sawyer, having then good reason to believe that the company was insolvent, purchased of one Hayes, for 33 per cent

[1] See also the Chapter on Issues of Stock at a Discount or for Overvalued Property, *supra*, and the Chapter on the Rights of Creditors as affected by Reorganizations, *infra*.

of its par value, a certificate of an adjusted loss for $5000 against the company.

In June, 1872, a petition in bankruptcy was filed against the company; and, it having been adjudicated a bankrupt, Hoag was appointed its assignee.

Hoag demanded of Sawyer payment of the note for $4250. Sawyer insisted that, under Section 20 of the Bankrupt Act, he had a right to set off the certificate of adjusted loss for $5000. Hoag refused to allow the set-off, and was about to sell the collateral securities in accordance with the authority given by Sawyer to the company. Thereupon Sawyer filed the present bill to enforce the set-off; alleging, among other things, that the note given by him to the company was for money lent to him. The assignee, in his answer, denied that the note was for money lent, and averred that it was in fact for a balance due by Sawyer for his stock subscription which had never been paid.

The case was submitted to the court below on an agreed statement of facts. That court decreed against the complainant, Sawyer, who appealed to this court.

MILLER, J. The first and most important question to be decided in this case is whether the indebtedness of the appellant to the insurance company is to be treated, for the purposes of this suit, as really based on a loan of money by the company to him, or as representing his unpaid stock subscription.

The charter under which the company was organized authorized it to commence business upon a capital stock of $100,000, with ten thousand paid in, and the remainder secured by notes with mortgages on real estate or otherwise. The transaction by which the appellant professes to have paid up his stock subscription is, shortly, this: He gave to the company his check for the full amount of his subscription, namely, $5000. He took the check of the company for $4250, being the amount of his subscription less the 15 per cent required of each stockholder to be paid in cash, and he gave his note for the amount of the latter check, with good collateral security for its payment, with interest at 7 per cent per annum. The appellant and the company, by its officers, agreed to call this latter transaction a loan, and the check of the appellant payment in full of his stock; and on the books of the company, and in all other respects as between themselves, it was treated as payment of the subscription and a loan of money. It is agreed that at this time the current rate of interest in Chicago was greater than 7 per cent, and it is not stated as a fact whether these checks were ever presented and paid at any bank, or that any money was actually paid or received by either party in the transaction. It must, therefore, be treated as an agreement between the corporation, by its officers, on the one part, and the appellant, as a subscriber to the stock of the company, on the other part, to convert the debt which the latter owed to the company for his stock into

a debt for the loan of money, thereby extinguishing the stock debt.

Undoubtedly this transaction, if nothing unfair was intended, was one which the parties could do effectually as far as they alone were concerned. Two private persons could thus change the nature of the indebtedness of one to the other if it was found to be mutually convenient to do so. And in any controversy which might or could grow out of the matter between the insurance company and the appellant we are not prepared to say that the company, as a corporate body, could deny that the stock was paid in full.

And on this consideration one of the main arguments on which the appellant seeks to reverse the decree stands. He assumes that the assignee in bankruptcy is the representative alone of the corporation, and can assert no right which it could not have asserted. The weakness of the argument is in this assumption. The assignee is the representative of the creditors as well as the bankrupt. He is appointed by the creditors. The statute is full of authority to him to sue for and recover property, rights, and credits, where the bankrupt could not have sustained the action, and to set aside as void transactions by which the bankrupt himself would be bound. All this, of course, is in the interest of the creditors of the bankrupt.

Had the creditors of this insolvent corporation any right to look into and assail the transaction by which the appellant claims to have paid his stock subscription?

Though it be a doctrine of modern date, we think it now well established that the capital stock of a corporation, especially its unpaid subscriptions, is a trust fund for the benefit of the general creditors of the corporation. And when we consider the rapid development of corporations as instrumentalities of the commercial and business world in the last few years, with the corresponding necessity of adapting legal principles to the new and varying exigencies of this business, it is no solid objection to such a principle that it is modern, for the occasion for it could not sooner have arisen.

The principle is fully asserted in two recent cases in this court, namely, *Burke* v. *Smith*, 16 Wall. 390, and in *New Albany* v. *Burke*, 11 Wall. 96. Both these cases turned upon the doctrine, we have stated, and upon the necessary inference from that doctrine that the governing officers of a corporation cannot, by agreement or other transaction with the stockholder, release the latter from his obligation to pay, to the prejudice of its creditors, except by fair and honest dealing and for a valuable consideration.

In the latter case, a judgment creditor of an insolvent railroad company, having exhausted his remedy at law, sought to enforce this principle by a bill in chancery against the stockholders. The court, by affirming the right of the corporation to deal with the debt due it for stock as with any other debt, would have ended the case without

further inquiry. But asserting, on the contrary, to its full extent, that such stock debts were trust funds in their hands for the benefit of the corporate creditors, and must in all cases be dealt with as trust funds are dealt with, it was found necessary to go into an elaborate inquiry to ascertain whether a violation of the trust had been committed. And though the court find that the transaction by which the stockholders had been released was a fair and valid one, as founded on the conditions of the original subscription, the assertion of the general rule on the subject is none the less authoritative and emphatic.

In the case before us the assignee of the bankrupt, in the interest of the creditors, has a right to inquire into this conventional payment of his stock by one of the shareholders of the company; and on that inquiry, we are of opinion that, as to these creditors, there was no valid payment of his stock by the appellant. We do not base this upon the ground that no money actually passed between the parties. It would have been just the same if, agreeing beforehand to turn the stock debt into a loan, the appellant had brought the money with him, paid it, taken a receipt for it, and carried it away with him. This would be precisely the equivalent of the exchange of checks between the parties. It is the intent and purpose of the transaction which forbids it to be treated as valid payment. It is the change of the character of the debt from one of a stock subscription unpaid to that of a loan of money. The debt ceases by this operation, if effectual, to be the trust fund to which creditors can look, and becomes ordinary assets, with which the directors may deal as they choose.

And this was precisely what was designed by the parties. It divested the claim against the stockholder of its character of a trust fund, and enabled both him and the directors to deal with it freed from that charge. There are three or four of these cases now before us in which precisely the same thing was done by other insurance companies organized in Chicago, and we have no doubt it was done by this company in regard to all their stockholders.

It was, therefore, a regular system of operations to the injury of the creditor, beneficial alone to the stockholder and the corporation.

We do not believe we characterize it too strongly when we say that it was a fraud upon the public who were expected to deal with them.

The result of it was that the capital stock of the company was neither paid up in actual money, nor did it exist in the form of deferred instalments properly secured.

It is said by the appellant's counsel that conceding this, it is still a debt due by him to the corporation at the time that he became the owner of the debt due by the corporation to Hayes, and, therefore, the proper subject of set-off under the twentieth section of the Bankrupt Act. That section is as follows: "In all cases of mutual debts or mutual credits between the parties, the account between them shall be stated, and one debt set off against the other, and the balance only

shall be allowed or paid, but no set-off shall be allowed of a claim in its nature not provable against the estate: *Provided*, that no set-off shall be allowed in favor of any debtor to the bankrupt of a claim purchased by or transferred to him after the filing of the petition."

This section was not intended to enlarge the doctrine of set-off, or to enable a party to make a set-off in cases where the principles of legal or equitable set-off did not previously authorize it.

The debts must be mutual; must be in the same right.

The case before us is not of that character. The debt which the appellant owed for his stock was a trust fund devoted to the payment of all the creditors of the company. As soon as the company became insolvent, and this fact became known to the appellant, the right of set-off for an ordinary debt to its full amount ceased. It became a fund belonging equally in equity to all the creditors, and could not be appropriated by the debtor to the exclusive payment of his own claim.

It is unnecessary to go into the inquiry whether this claim was acquired before the commission of an act of bankruptcy by the company, or the effect of the bankruptcy proceeding. The result would be the same if the corporation was in the process of liquidation in the hands of a trustee or under other legal proceedings. It would still remain true that the unpaid stock was a trust fund for all the creditors, which could not be applied exclusively to the payment of one claim, though held by the stockholder who owed that amount on his subscription.

Nor do we think the relation of the appellant in this case to the corporation is without weight in the solution of the question before us. It is very true, that by the power of the legislature there is created in all acts of incorporation a legal entity which can contract with its shareholders in the ordinary transactions of business as with other persons. It can buy of them, sell to them, make loans to them, and in insurance companies, make contracts of insurance with them, in all of which both parties are bound by the ordinary laws of contract. The stockholder is also relieved from personal liability for the debts of the company. But after all, this artificial body is but the representative of its stockholders, and exists mainly for their benefit, and is governed and controlled by them through the officers whom they elect. And the interest and power of legal control of each shareholder is in exact proportion to the amount of his stock. It is, therefore, but just that when the interest of the public, or of strangers dealing with this corporation is to be affected by any transaction between the stockholders who own the corporation and the corporation itself, such transaction should be subject to a rigid scrutiny, and if found to be infected with anything unfair towards such third person, calculated to injure him, or designed intentionally and inequitably to screen the

stockholder from loss at the expense of the general creditor, it should be disregarded or annulled so far as it may equitably affect him.

These principles require the affirmation of the decree in the present case, and it is accordingly *Affirmed.*

Mr. Justice Hunt dissented, holding that the transaction was a loan by the company to the appellant.

OAKES *v.* TURQUAND.

L.R. 2 H.L. 325. 1867.

Overend, Gurney & Co., Limited, a company formed under the Companies Act of 1862, became financially involved and was wound up. Oakes moved that his name be stricken from the list of contributories, on the ground that he had been induced to become a member of the company by the fraudulent representations of its directors. The motion was denied.

Lord Cranworth. My Lords, the appellant, Mr. Oakes, in order to sustain his appeal, must make out two propositions. He must satisfy the House, first, that he was induced to take his shares in Overend, Gurney & Co., Limited, by the fraud of the company, or of those for whom the company became responsible; and, secondly, if that is made out, that he ought not to be retained on the list of contributories. The first question is one of fact, and its determination, however important to the parties concerned, is of no general interest. The other question is of very extensive consequence in the mercantile world. It is of the utmost importance that persons dealing with joint-stock companies should be in no doubt as to who are the persons to whom they are entitled to look as liable to perform the obligations and pay the debts of the partnership.

I shall proceed at once to consider this second question — to determine what are the relative rights of Mr. Oakes and the creditors, and for this purpose shall assume it to be true that he was induced to take shares by the fraud of the company, or of those for whom the company became responsible. There is no doubt that the direct remedy of a creditor is solely against the incorporated company. He has no dealing with any individual shareholder, and if he is driven to bring an action to enforce any right he may have acquired, he must sue the company, and not any of the members of whom it is composed. This being so, the argument of the appellant is, that it is only to the assets of the company that the creditor can resort, and so that the only question is, of what those assets consist. This question, he contends, so far as the assets consist of money to be recovered by legal process against other persons, whether shareholders or not, can only be solved by ascertaining what rights the company has against

those other persons. If in any proceeding by the company instituted for the purpose of recovering money from any person, that person has a valid defence, whether legal or equitable, the appellant contends that the sum claimed from him does not form part of the assets of the company. These assets, he says, consist solely of property in the actual possession of the company, or which the company can recover by means of legal proceedings. In this case the appellant contends that he was induced to become a shareholder by means of a fraud which entitles him to repudiate the status of shareholder, and to say, as between himself and the company, that he never held a share. And if he can say this against the company, then the appellant contends he can say it against all the world, for his liability is a liability to the company and to no one else.

. . . Section 74 [of the Companies Act] defines contributories to be all persons liable to contribute to the assets in the event of the company being wound up; and section 38 declares that on that event every present and past member shall be liable to contribute subject to certain qualifications. In order to ascertain who are designated by the word "members" in section 38, we must refer to section 23, which states that every person who has agreed to become a member, and whose name is entered on the register, shall be deemed to be a member of the company.

The name of Mr. Oakes was certainly entered on the register; if, therefore, he agreed to become a member within the meaning of this 23d section, he is a contributory. The argument is, that he did not so agree, because all which he did, he did under the influence of fraud and misrepresentation. But assuming all that to be, and I believe it was, just as Mr. Oakes represents it, still he did agree to become a member — that is, he in fact agreed. He may have full rights against those who deceived him, but with that the outer world can have no concern. *Appeal dismissed.*

NOTE. — Although a stockholder was induced by corporate fraud to take stock, his right of rescission is cut off by the insolvency of the corporation, — at least, as to creditors who became such after his subscription. See *Gress* v. *Knight*, 135 Ga. 60; *Meholin* v. *Carlson*, 17 Idaho, 742; *Foster* v. *Row*, 120 Mich. 1; *Olson* v. *Bank*, 67 Minn. 267; *Howard* v. *Turner*, 155 Pa. 349; *Burleson* v. *Davis*, 141 S.W. (Tex.) 559; *Jordan* v. *Annex Corporation*, 109 Va. 625; *Cox* v. *Dickie*, 48 Wash. 264; *Scott* v. *Deweese*, 181 U.S. 202.

But see *Marion Trust Co.* v. *Blish*, 170 Ind. 686; *Hinkley* v. *Oil Co.* (insolvency proceedings not instituted), 132 Iowa, 396; *Ky. Mutual Co.'s Assignee* v. *Schaefer*, 120 Ky. 227 (*cf. Reid* v. *Owensboro Co.*, 141 Ky. 444, 451); *Fear* v. *Bartlett*, 81 Md. 435 (stockholder gave corporation notice of rescission while it was solvent); *Ramsey* v. *Thompson Mfg. Co.*, 116 Mo. 313.

McDONALD, RECEIVER, *v.* WILLIAMS.

174 U.S. 397. 1899.

SUIT by receiver of the Capital National Bank of Lincoln, Nebraska, to recover from defendants, stockholders in the bank, the amount of certain dividends previously received by them.

When the dividend of January 6, 1889, was declared and paid, and when each subsequent dividend, down to and including July, 1891, was declared and paid, there were no net profits. The capital of the bank was impaired, and the dividends were paid out of the capital, but the bank was still solvent. When the dividends of January and July, 1892, were declared and paid there were no net profits, the capital of the bank was lost, and the bank actually insolvent.

The defendants, neither of whom was an officer or director, were ignorant of the financial condition of the bank, and received the dividends in good faith, relying on the officers of the bank, and believing the dividends were coming out of the profits.

Upon these facts the court desired the instruction of this court on the question:

Can the receiver of a national bank recover a dividend paid not at all out of profits, but entirely out of the capital, when the stockholder receiving such dividend acted in good faith, believing the same to be paid out of the profits, and when the bank, at the time such dividend was declared and paid, was not insolvent?

PECKHAM, J. . . . The complainant bases his right to recover in this suit upon the theory that the capital of the corporation was a trust fund for the payment of creditors entitled to a portion thereof, and having been paid in the way of dividends to the shareholders that portion can be recovered back in an action of this kind for the purpose of paying the debts of the corporation. He also bases his right to recover upon the terms of section 5204 of the Revised Statutes.

We think the theory of a trust fund has no application to a case of this kind. When a corporation is solvent, the theory that its capital is a trust fund upon which there is any lien for the payment of its debts has in fact very little foundation. No general creditor has any lien upon the fund under such circumstances, and the right of the corporation to deal with its property is absolute so long as it does not violate its charter or the law applicable to such corporation.

In *Graham* v. *Railroad Company*, 102 U.S. 148, 161, it was said by Mr. Justice BRADLEY, in the course of his opinion, that "when a corporation becomes insolvent, it is so far civilly dead that its property may be administered as a trust fund for the benefit of its stockholders and creditors, and a court of equity, at the instance of the proper parties, will then make those funds trust funds, which, in other cir-

cumstances, are as much the absolute property of the corporation as any man's property is his." . . .

These cases, while not involving precisely the same question now before us, show there is no well-defined lien of creditors upon the capital of a corporation while the latter is a solvent and going concern, so as to permit creditors to question, at the time, the disposition of the property.

The bank being solvent, although it paid its dividends out of capital, did not pay them out of a trust fund. Upon the subsequent insolvency of the bank and the appointment of a receiver, an action could not be brought by the latter to recover the dividends thus paid on the theory that they were paid from a trust fund, and therefore were liable to be recovered back.

It is contended on the part of the complainant, however, that if the assets of the bank are impressed with a trust in favor of its creditors when it is insolvent, they must be impressed with the same trust when it is solvent; that the mere fact that the value of the assets of the corporation has sunk below the amount of its debts, although as yet unknown to any body, cannot possibly make a new contract between the corporation and its creditors. In case of insolvency, however, the recovery of the money paid in the ordinary way without condition is allowed, not on the ground of contract to repay, but because the money thus paid was in equity the money of the creditor; that it did not belong to the bank, and the bank in paying could bestow no title in the money it paid to one who did not receive it *bona fide* and for value. The assets of the bank, while it is solvent, may clearly not be impressed with a trust in favor of creditors, and yet that trust may be created by the very fact of the insolvency, and the trust enforced by a receiver as the representative of all the creditors. But we do not wish to be understood as deciding that the doctrine of a trust fund does in truth extend to a shareholder receiving a dividend, in good faith believing it is paid out of profits, even though the bank at the time of the payment be in fact insolvent. That question is not herein presented to us, and we express no opinion in regard to it. We only say, that if such a dividend be recoverable, it would be on the principle of a trust fund. . . .

Without reference to the statute, therefore, we think the right to recover the dividend paid while the bank was solvent would not exist.

But it is urged on the part of the complainant that section 5204 of the Revised Statutes makes the payment of a dividend out of capital illegal and *ultra vires* of the corporation, and that money thus paid remains the property of the corporation, and can be followed into the hands of any volunteer.

The section provides that "no association, or any member thereof, shall, during the time it shall continue its banking operations, withdraw, or permit to be withdrawn, either in the form of dividends or

otherwise, any portion of its capital." What is meant by this language? Has a shareholder withdrawn or permitted to be withdrawn in the form of a dividend any portion of the capital of the bank when he has simply and in good faith received a dividend declared by a board of directors of which he was not a member, and which dividend he honestly supposed was declared only out of profits? Does he in such case within the meaning of the statute withdraw or permit to be withdrawn a portion of the capital? The law prohibits the making of a dividend by a national bank from its capital or to an amount greater than its net profits then on hand, deducting therefrom its losses and bad debts. The fact of the declaration of a dividend is in effect the assertion by the board of directors that the dividend is made out of profits. Believing that the dividend is thus made, the shareholder in good faith receives his portion of it. Can it be said that in thus doing he withdraws or permits to be withdrawn any portion of the capital of the corporation? We think he does not withdraw it by the mere reception of his proportionate part of the dividend. The withdrawal was initiated by the declaration of the dividend by the board of directors, and was consummated on their part when they permitted payment to be made in accordance with the declaration. We think this language implies some positive or affirmative act on the part of the shareholder by which he knowingly withdraws the capital or some portion thereof, or with knowledge permits some act which results in the withdrawal, and which might not have been so withdrawn without his action. The permitting to be withdrawn cannot be founded upon the simple receipt of a dividend under the facts stated above.

One is not usually said to permit an act which he is wholly ignorant of, nor would he be said to consent to an act of the commission of which he had no knowledge. Ought it to be said that he withdraws or permits the withdrawal by ignorantly yet in entire good faith receiving his proportionate part of the dividend? Is each shareholder an absolute insurer that dividends are paid out of profits? Must he employ experts to examine the books of the bank previous to receiving each dividend? Few shareholders could make such examination themselves. The shareholder takes the fact that a dividend has been declared as an assurance that it was declared out of profits and not out of capital, because he knows that the statute prohibits any declaration of a dividend out of capital. Knowing that a dividend from capital would be illegal, he would receive the dividend as an assurance that the bank was in a prosperous condition and with unimpaired capital. Under such circumstances we cannot think that Congress intended by the use of the expression "withdraw or permit to be withdrawn, either in the form of dividends, or otherwise," any portion of its capital, to include the case of the passive receipt of a dividend by a shareholder in the *bona fide* belief that the dividend

was paid out of profits, while the bank was in fact solvent. We think it would be an improper construction of the language of the statute to hold that it covers such a case.

We are strengthened in our views as to the proper construction of this act by reference to some of its other sections. The payment of the capital within a certain time is provided for by sections 5140 and 5141. Section 5151 provides for the individual responsibility of each shareholder to the extent of his stock at the par value thereof in addition to the amount invested therein. (These shareholders have already been assessed under this section.) And section 5205 provides for the case of a corporation whose capital shall have become impaired by losses *or otherwise*, and proceedings may be taken by the association against the shareholders for the payment of the deficiency in the capital within three months after receiving notice thereof from the Comptroller. These various provisions of the statute impose a very severe liability upon the part of holders of national bank stock, and while such provisions are evidently imposed for the purpose of securing reasonable safety to those who deal with the banks, we may nevertheless say, in view of this whole system of liability, that it is unnecessary, and that it would be an unnatural construction of the language of section 5204 to hold that in a case such as this a shareholder, by the receipt of a dividend from a solvent bank, had withdrawn or permitted to be withdrawn any portion of its capital.

We may concede that the directors who declared the dividend under such circumstances violated the law, and that their act was therefore illegal, but the reception of the dividend by the shareholder in good faith, as mentioned in the question, was not a wrongful or designedly improper act. Hence the liability of the shareholder should not be enlarged by reason of the conduct of the directors. They may have rendered themselves liable to prosecution, but the liability of the shareholder is different in such a case, and the receipt of a dividend under the circumstances is different from an act which may be said to be generally illegal, such as the purchase of stock in one national bank by another national bank for an investment merely, which is never proper. *Concord First National Bank* v. *Hawkins*, just decided, *ante*, 364.

The declaration and payment of a dividend is part of the course of business of these corporations. It is the thing for which they are established, and its payment is looked for as the appropriate result of the business which has been done. The presumption of legality attaches to its declaration and payment, because declaring it, is to assert that it is payable out of the profits. As the statute has provided a remedy under section 5205 for the impairment of the capital which includes the case of an impairment produced by the payment of a dividend, we think the payment and receipt of a dividend under the circumstances detailed in the question certified do not permit of

its recovery back by a receiver appointed upon the subsequent insolvency of the bank.

The facts in the various English cases cited by counsel for complainant are so entirely unlike those which exist in this case that no useful purpose would be subserved by a reference to them. Not one holds that a dividend declared under such facts as this case assumes can be recovered back in such an action as this.

We answer the question in the negative.

NOTE. — After the Supreme Court had given the above opinion, the Circuit Court of Appeals rendered judgment against the receiver as to the dividends in the years when the bank was still solvent, and against the defendant stockholders for the dividends paid during insolvency. LACOMBE, J., said: "No question was propounded" (i.e., to the Supreme Court) "as to the dividends paid when the bank was actually insolvent, as we had no doubt the receiver could recover them in a proper action." *Hayden* v. *Williams*, 96 Fed. Rep. 279, pp. 283, 284. See also *Hammond* v. *Hammond Co.*, 72 Conn. 130.

See, in *accord* with the principal case, *In re Denham & Co.*, L.R. 25 Ch.D. 752.

See, *contra*, *Lexington Insurance Co.* v. *Page*, 17 B. Mon. (Ky.) 412 (dividends declared by the directors, and received by the stockholders, may be reclaimed by the directors, if illegally declared under a misapprehension of the right to declare them); *American Steel & Wire Co.* v. *Eddy*, 138 Mich. 403 (statute); *Williams* v. *Boice*, 38 N.J. Eq. 364, 367.

BOOK VII.

THE REORGANIZATION OF CORPORATIONS.

CHAPTER I.

ISSUES OF STOCK BY A CORPORATION WITH IMPAIRED CAPITAL.

HANDLEY *v.* STUTZ.

139 U.S. 417. 1891.

Creditors of the Clifton Coal Company sought to require stockholders to pay the difference between the par value of their stock and the amount they had paid for such stock. Some of this stock had been issued some years after the corporation was organized, and at a time when the market value of its stock was less than par. The lower court held that all creditors who became such after this issue of stock were entitled to the relief asked for.

Mr. Justice Brown. Some three years after the company was organized it became apparent that the enterprise, as originally contemplated, namely, the mining and selling of coal for steam and domestic purposes, was not likely to be a success, owing to the inferior character of the product; and the only hope of the company lay in the manufacture of the coal into an iron-making coke, that is, a coke containing a percentage of sulphur low enough to admit of the manufacture of merchantable pig iron. To embark in this, however, money was needed, and as the stock of the company was not worth more than 50 cents on the dollar, it was evident this could not be effected simply by the issue of new stock. It was proposed at the meeting in March that money should be raised by the issue of $50,000 of bonds, with which to add the requisite structures to the plant. But it was soon evident that the bonds could not be negotiated without the stock, and, acting upon the suggestion of a Nashville banker, it was resolved at the meeting in May that the stock should be increased 800 shares, 500 of which should be turned over to the subscribers to the bonds, as a bonus or an additional consideration. The evidence is uncontradicted that the bonds could not have been negotiated without the stock; that they were both sold as a whole; that the transaction was in good faith, and, considering the risk that was taken by the subseribers, the price paid for the stock and bonds was

fair and reasonable. The directors appear to have done all in their power to obtain the best possible terms, and there is no imputation of unfair dealing on the part of any one connected with the transaction. At that time the mines and property of the company were in good condition, and the prospects of success were fair.

The case then resolves itself into the question whether an active corporation, or as it is called in some cases, a "going concern," finding its original capital impaired by loss or misfortune, may not, for the purpose of recuperating itself and providing new conditions for the successful prosecution of its business, issue new stock, put it upon the market and sell it for the best price that can be obtained. The question has never been directly raised before in this court, and we are not, consequently, embarrassed by any previous decisions on the point. In the *Upton Cases*, arising out of the failure of the Great Western Insurance Company; in *Hatch* v. *Dana*, 101 U.S. 205, and in *Hawkins* v. *Glenn*, 131 U.S. 319, the defendants were either original subscribers to the increased stock, at a price far below its par value, or transferees of such subscribers; and the stock was issued, not as in this case to purchase property or raise money to add to the plant, and facilitate the operations of the company, but simply to increase its original stock in order to carry on a larger business, and the stock thus issued was treated as if it formed a part of the original capital. In *County of Morgan* v. *Allen*, 103 U.S. 498, the same principle was applied to a subscription by a county to the capital stock of a railroad company, for which it had issued its bonds, although such bonds had been surrendered to the county with the consent of certain of its creditors.

To say that a corporation may not, under the circumstances above indicated, put its stock upon the market and sell it to the highest bidder, is practically to declare that a corporation can never increase its capital by a sale of shares, if the original stock has fallen below par. The wholesome doctrine, so many times enforced by this court, that the capital stock of an insolvent corporation is a trust fund for the payment of its debts, rests upon the idea that the creditors have a right to rely upon the fact that the subscribers to such stock have put into the treasury of the corporation, in some form, the amount represented by it; but it does not follow that every creditor has a right to trace each share of stock issued by such corporation, and inquire whether its holder, or the person of whom he purchased, has paid its par value for it. It frequently happens that corporations, as well as individuals, find it necessary to increase their capital in order to raise money to prosecute their business successfully, and one of the most frequent methods resorted to is that of issuing new shares of stock and putting them upon the market for the best price that can be obtained; and so long as the transaction is *bona fide*, and not a mere cover for "watering" the stock, and the consideration ob-

tained represents the actual value of such stock, the courts have shown no disposition to disturb it. Of course no one would take stock so issued at a greater price than the original stock could be purchased for, and hence the ability to negotiate the stock and to raise the money must depend upon the fact whether the purchaser shall or shall not be called upon to respond for its par value. While, as before observed, the precise question has never been raised in this court, there are numerous decisions to the effect that the general rule that holders of stock, in favor of creditors, must respond for its par value, is subject to exceptions where the transaction is not a mere cover for an illegal increase.

Thus in *New Albany* v. *Burke*, 11 Wall. 96, a city subscribed to the stock of a railroad, and issued bonds for a part of the subscription, agreeing to issue them for the rest of it, when the road should be built to a certain point. The road relied mainly upon these bonds to raise the necessary money. The validity of the bonds being denied by tax-payers, who had filed bills to enjoin the raising of a tax to pay the interest, their value in the market was largely impaired, and it was found they could not be sold without a sacrifice. Under these circumstances the company applied to the city to pay a certain sum which had been borrowed by the road upon the pledge of the bonds already issued, with sundry other moneys, and in consideration thereof the city obtained from the company a large number of bonds which had not been negotiated, and a cancellation of the subscription. In a suit brought by a judgment creditor to enforce the original subscription, it was held that the compromise was legal, and the payment of such subscription would not be enforced, although it subsequently turned out that the bonds were worth more than they could have been sold for. Said Mr. Justice STRONG, speaking for the court: "Had the company sold to a stranger, and then the city become a purchaser from the stranger, it will not be contended that any creditor of the company could complain. And it can make no difference whether the purchase was made directly or indirectly from the first holder of the bonds, assuming that there was no fraud. The transaction . . . was, in substance, plainly nothing more than a purchase by the city of its own bonds, some of which had been issued and others of which it was under obligation to issue, at the call of the vendor. . . . Looking at it in the light of subsequent events, it was no doubt an advantageous purchase for the city; and, if the uncontradicted evidence is to be believed, it was deemed at the time an advantageous sale or arrangement for the company. . . . We may add, the evidence is convincing that the contract between the city and the company was made in the utmost good faith, with no intention to wrong creditors of the latter; that it was at the time considered advantageous to the company, and it is not proved that all was not paid for the bonds issued and to be issued that they could have been sold for in the market."

So in *Coit* v. *Gold Amalgamating Company*, 119 U.S. 343, it was held that where the charter of a corporation authorizes the capital stock to be paid for in property, and the shareholders honestly and in good faith pay for their subscriptions in property instead of money, third parties have no ground of complaint, although a gross and obvious over-valuation of such property would be strong evidence of fraud in an action by a creditor to enforce personal liability. The court held that where full-paid stock was issued for property received there must be actual fraud in the transaction to enable creditors of the corporation to call the stockholders to account. In delivering the judgment of the court in that case at the circuit, 14 Fed. Rep. 12, Mr. Justice BRADLEY observed: "That trust [in favor of creditors] does not arise absolutely in every case where capital stock has been issued, and where it has been settled for by arrangement with the company. It is not as if the stockholders had given their promissory notes for the amount, these notes being in the treasury of the company; but there are often equities to which the stockholders are entitled — on which they are to stand." As one of them, he mentioned the case of stock dividends fairly made in consideration of profits earned and of accumulations of the property of the company, and observed: "It is not true that it is in the power of a creditor in every case, and in all cases, as a mere matter of right, to institute an inquiry as to the valuation of the amount of the consideration given for the stock, and disturb fair arrangements for its payment in other ways than by cash. If the stock has been fairly created and paid for, there is an end of trusts in favor of any body; and this does not affect the general proposition that unpaid subscriptions of stock are a trust fund to be administered for the benefit of creditors after a corporation becomes insolvent."

A case nearer in point is that of *Clark* v. *Bever*, 139 U.S. 96, decided at the present term of this court. In this case, a railroad company, of which defendant's intestate was president and stockholder, had a settlement with a construction company, of which defendant's intestate was also a member, for work done in building the road. The railroad company, being unable to pay the claim of the construction company, delivered to it thirty-five hundred shares of its stock at 20 cents on the dollar, and the same were accepted in full satisfaction of the debt. The stock was not worth anything in the market, and was issued directly to the defendant's intestate. No other payment than the 20 per cent was ever made on account of this stock. A judgment creditor of the railroad company filed a bill to compel the payment by the defendant of his claim, upon the theory that he was liable for the actual par value of such stock, whatever may have been its market value at the time it was received. It was held he could not recover. "Of course, under this view," says Mr. Justice HARLAN, in delivering the opinion of the court, "every one having claims

against the railway company, — even laborers and employés, — who could get nothing except stock in payment of their demands, became bound, by accepting stock at its market value in payment, to account to unsatisfied judgment creditors for its full face value, although, at the time it was sought to make them liable, the corporation had ceased to exist, or its stock had remained, as it was when taken, absolutely worthless. . . . To say that a public corporation, charged with public duties, may not relieve itself from embarrassment by paying its debt in stock at its real value, — there being no statute forbidding such a transaction, — without subjecting the creditor, surrendering his debt, to the liability attaching to stockholders who have agreed, expressly or impliedly, to pay the face value of stock subscribed by them, is, in effect, to compel them either to suspend operations the moment they become unable to pay their current debts, or to borrow money secured by mortgage upon the corporate property."

So in *Fogg* v. *Blair*, 139 U.S. 118, also decided at the present term, it was held to be competent for a railroad, exercising good faith, to use its bonds or stock in payment for the construction of its road, although it could not, as against creditors or stockholders, issue its stock as fully paid without getting some fair or reasonable equivalent for it. It was there said: "What was such an equivalent depends primarily upon the actual value of the stock at the time it was contracted to be issued, and upon the compensation which, under all the circumstances, the contractors were equitably entitled to receive for the particular work undertaken or done by them." It appeared in that case that full and adequate compensation for the work done had been paid by the company in its mortgage bonds, and, as the bill contained no allegation whatever as to the real or market value of such stock, it was held that the contractors receiving this stock were not liable to creditors for its par value. It was added: "If, when disposed of by the railroad company, it was without value, no wrong was done to creditors by the contract made with Blair and Taylor. If the plaintiff expected to recover in this suit on the ground that the stock was of substantial value, it was incumbent upon him to distinctly allege facts that would enable the court — assuming such facts to be true — to say that the contract between the railroad company and the contractors was one which, in the interest of creditors, ought to be closely scrutinized." It would seem to follow from this that if the stock had been of some value, that value, however much less than par, would have been the limit of the holder's liability.

In *Morrow* v. *Nashville Iron and Steel Co.*, 87 Tennessee, 262, 275, 276, the Supreme Court of Tennessee held, that a contract with a subscriber to stock of a corporation, that for every share subscribed he should receive bonds to an equal amount, secured by mortgage on the company's plant, is void as against creditors, and also between

the subscriber and the corporation. But the court drew a distinction between such a case and sales of or subscription to the stock of an organized and going corporation. It said: "The necessities of the business of an organized company might demand an increase of capital stock, and if such stock is lawfully issued, it may very well be offered upon special terms. In such case, if the market price was less than par, it is clear that a purchaser or subscriber for such stock at its market value would, in the absence of fraud, be liable only for his contract price. So a case might arise where the stock of a going concern was much depreciated, and where its bonds were likewise below par, and there was lawful authority to issue additional stock and bonds. Now, in such case, the real market value of an equal amount of stock and bonds might not exceed, or even equal, the par value of either. In such cases, the question of fraud aside, a purchaser would only be held for his contract price." This case from Tennessee puts as an illustration the exact case with which we are now dealing.

The liability of a subscriber for the par value of increased stock taken by him may depend somewhat upon the circumstances under which, and the purposes for which, such increase was made. If it be merely for the purpose of adding to the original capital stock of the corporation, and enabling it to do a larger and more profitable business, such subscriber would stand practically upon the same basis as a subscriber to the original capital. But we think that an active corporation may, for the purpose of paying its debts, and obtaining money for the successful prosecution of its business, issue its stock and dispose of it for the best price that can be obtained. *Stein* v. *Howard*, 65 California, 616. As the company in this case found it impossible to negotiate its bonds at par without the stock, and as the stock was issued for the purpose of enhancing the value of the bonds, and was taken by the subscribers to the bonds at a price fairly representing the value of both stock and bonds, we think the transaction should be sustained, and that the defendants cannot be called upon to respond for the par value of such stock, as if they had subscribed to the original stock of the company.

MR. CHIEF JUSTICE FULLER, with whom concurred MR. JUSTICE LAMAR, dissenting.

I dissent from the conclusion of the court in respect of the stock received by the subscribers to the bonds. That stock was not paid for in money or money's worth, or issued in payment of debts due from the company, or purchased at sale upon the market. It was a mere bonus, thrown in with the bonds as furnishing the inducement to the bond subscription, of larger control over the corporation, and of possible gain without expenditure. Becoming secured creditors through the bonds, the subscribers increased their power through the stock. In my view, there was no actual payment for the stock, and to treat it as paid up, is to sanction an arrangement to relieve those

who would reap the benefit derived from the possession of the stock, in the event of the success, from liability for the consequences, in the event of the failure, of the enterprise.

When the capital stock of a corporation has become impaired, or the business in which it has engaged has proven so unremunerative as to call for a change, creditors at large may well demand that experiments at rehabilitation should not be conducted at their risk.

My brother LAMAR concurs with me in this dissent.

NOTE. — See, *accord*, *Stein* v. *Howard*, 65 Cal. 616; *McDowell* v. *Lindsay*, 213 Pa. 591 (W.Va. statute).

KRAFT *v.* GRIFFON CO.

82 N.Y. App. Div. 29. 1903.

LAUGHLIN, J. This is an action by a stockholder of the Griffon Company to enjoin a second issue of stock to be given as a bonus on the sale of company bonds for their value.

The original capital stock was $25,000, one-half of which was issued to the plaintiff and the other half to the defendant Ernest F. Greff, Jr. Down to the 1st day of July, 1900, there was a continuous and increasing impairment of the capital, and the company was seriously in need of funds. At a meeting of the stockholders, held for that purpose on the 11th day of September, 1900, the capital stock was increased to $150,000, of which $50,000 was preferred. This preferred stock was sold at par, but the common stock was not sold at all. The company being again pressed for funds, on the 26th of February, 1901, determined to issue certificates of indebtedness to the extent of $30,000, but only one-half of the amount was sold. On the 25th day of May, 1901, public accountants employed to investigate and make statement of the financial condition of the company, reported that its then capital of $75,000 was impaired to the extent of $41,602.85. The company being unable to make a further sale of the capital stock or otherwise raise necessary funds for paying current obligations and continuing the business, the board of directors on the 20th day of August, 1901, adopted a resolution authorizing the issue of bonds to the extent of $75,000 with interest at six per cent payable quarterly or semi-annually and authorizing the president and treasurer to issue, negotiate and sell the same upon the best terms obtainable and authorizing the issue and delivery of $75,000 capital stock to be offered and delivered as a bonus to the purchasers of the bonds to an extent not exceeding the par value of the bonds purchased. One-half of this issue of bonds and stock was tendered to the plain-

tiff, who declined the offer, and the other half to the defendant Ernest F. Greff, Jr., who accepted and paid par for the bonds to the extent of $37,000 and the bonds and an equal amount of stock were delivered to him. The plaintiff then brought this action to enjoin the further issue of stock to be given as a bonus on the sale of bonds and to cancel the stock already issued as a bonus.

The appellant contends that the issue of stock to be delivered as a bonus to the purchasers of bonds of the corporation is unauthorized. The questions presented upon the appeal depend upon the construction of § 48 of the General Corporation Law of New Jersey (Laws of N.J. of 1896, chap. 185), which provides as follows: "Nothing but money shall be considered as payment of any part of the capital stock of any corporation organized under this act, except as hereinafter provided in case of the purchase of property, and no loan of money shall be made to a stockholder or officer thereof; and if any such loan be made the officers who make it, or assent thereto, shall be jointly and severally liable, to the extent of such loan and interest, for all the debts of the corporation until the repayment of the sum so loaned."

The exception referred to in this section is contained in § 49 and it relates exclusively to the issue of stock in payment for property purchased by the corporation and necessary for its benefit and provides that the stock so issued shall not exceed the value of the property to pay for which it is issued. It is conceded that these are the only provisions of New Jersey law applicable. Manifestly, neither the stock nor bonds are issued in payment for property purchased by the corporation within the exception contained in § 48. It will be observed that § 48 makes no distinction between the consideration for which the original stock may be issued and that for which an authorized increase of stock may be issued. No authoritative decision on the point is cited and we find none. The trial court has found, and the finding is, we think, sustained by the evidence, that on account of the impairment of the capital the par value of the bonds is all that the bonds together with the stock issued as a bonus were worth, and that, therefore, the transaction is not inequitable as against existing stockholders. There is a dictum in *Morrow* v. *Iron & Steel Co.* (87 Tenn. 262) to the effect that where the original capital has become impaired, the corporation may issue new stock at its actual or market value, and Morawetz on Corporations (2d ed. § 306) to the same effect is cited as authority for that proposition. The only point decided in that case, however, was that the original stock could not be issued for less than par, and it does not appear that there was any statute of the State under which the company was incorporated prohibiting the issue of stock for less than its face value. This dictum in the *Morrow* case was approved in *Handley* v. *Stutz* (139 U.S. 417) where it appears, however, that the subsequent

issue of stock for less than par was authorized by all the stockholders, and in that case, apparently, there was no statutory prohibition against such action, and the complaint was by prior creditors who could not be affected thereby. In *Dickerman* v. *Northern Trust Co.* (176 U.S. 181) it was held that bonds issued and stock given therewith as a bonus were valid in the hands of *bona fide* purchasers as against stockholders suing in the right of the corporation, but it was intimated that they might not be as against creditors. In *Donald* v. *American Smelting & Refining Co.* (62 N.J. Eq. 729) the issue of an increase of corporate stock in payment for property worth less than the par value of the stock was enjoined. (See, also, *Peck* v. *Elliott*, 79 Fed. Rep. 10.) By analogy, the *Donald* case would seem to be an authority against the issue of stock as a bonus with the bonds, for there seems to be no reason for distinction between subsequent issue of stock for property worth less than its par value and the subsequent issue of stock with bonds for money. In *Dummer* v. *Smedley* (110 Mich. 466) it was held that stock issued to a mortgagee as a bonus for moneys advanced was valid as to prior creditors, and also as to subsequent creditors if issued in good faith and for full market value. It is clear that the issue of this stock as a bonus with the bonds would not be binding upon subsequent creditors of the company, for the stockholders cannot thus enable the company to obtain credit upon the strength of its capital stock without paying into the treasury of the corporation the par value of their stock or delivering to it property of equal value. (*See* v. *Heppenheimer*, 55 N.J. Eq. 240; *Boney* v. *Williams*, id. 691; *Edgerton* v. *Electric Improvement, &c., Co.*, 50 id. 354; *Rickerson Roller-Mill Co.* v. *Farrell Foundry & Machine Co.*, 75 Fed. Rep. 554; *Scovill* v. *Thayer*, 105 U.S. 143, 153; *Donald* v. *American Smelting & Refining Co., supra; Dickerman* v. *Northern Trust Co., supra.*)

In *Hebberd* v. *Southwestern Land & Cattle Co.* (55 N.J. Eq. 31) it was stated that where a corporation contracted with the purchaser of its bonds to issue bonus stock "such a contract is binding upon the company and its shareholders," but that the purchaser of the stock could be compelled to pay the par value of the stock for the benefit of subsequent creditors. The effect of the decisions seems to be that neither before nor after consummation of a sale of bonds, with a delivery to the purchaser of the stock as a bonus, can the purchaser at the instance of the corporation or of a stockholder be compelled to pay into the treasury of the corporation the par value of the stock, and that an innocent *bona fide* holder of the stock for value and without notice probably would not be forced to contribute further even for the benefit of creditors. Subscriptions for capital stock and the money or property paid therefor constitute a trust fund for the benefit of creditors who, in dealing with the corporation, have a right to assume that the stock has been issued for cash or for property of

equivalent value, and the persons to whom the stock was originally issued may, for the benefit of subsequent creditors, be compelled to restore the difference between the par value of the stock and the amount they paid therefor. This seems clear under the New Jersey statute and decisions. Such being the case, the issue of this stock at less than par will be a fraud upon creditors. We are asked to permit this fraud to be perpetrated merely because it is not inequitable as to existing stockholders who only at the present time are complaining. We are of opinion, however, that § 48 of the New Jersey General Corporation Law, already quoted, should be given full force and effect according to its tenor. It in express terms prohibits the issue of any stock except for its par value in cash or the equivalent in property. Hence it appears to us that the issue made and the other issue contemplated is unauthorized and, therefore, illegal.

So far as the bonds have not been sold and stock issued, there appears to be no difficulty in the way of affording injunctive relief. The case is somewhat different, however, with reference to the bonds and stock already issued. As to that, two questions may arise, *first*, the right of the corporation, for this action is brought by a stockholder in its right, to rescind, and, *second*, whether the bonds and stock have reached the hands of an innocent purchaser for value who may in any event be entitled to protection to the extent of the value paid therefor. If this, instead of being an executed contract, were an executory contract between the corporation and a purchaser for the sale and purchase of these bonds with the stock as a bonus and the corporation refused to perform, we think it clear that the purchaser could not enforce performance; but, it being an executed contract, the corporation, probably, cannot rescind in any event without returning the moneys received by it, and we are not informed as to whether it is in a position to do that. Furthermore, it appears that the defendant Ernest F. Greff, Jr., has sold the stock and bonds to the copartnership of Greff & Co., of which he is a member, although the stock still stands in his name on the books of the company, and the other members of the firm are not parties. It may be, even if the corporation is not in a position to rescind as to the consummated transaction, that in the interests of future creditors the court should enjoin the further transfer of the stock to prevent the same reaching the hands of *bona fide* purchasers without notice. These questions, however, should not be decided on this appeal.

NOTE. — See also *Vaughn* v. *Alabama National Bank*, 143 Ala. 572; *New Haven Trust Co.* v. *Gaffney*, 73 Conn. 480; *Jackson* v. *Traer*, 64 Iowa, 469; *Peter* v. *Union Mfg. Co.*, 56 Ohio, 181.

A corporation organized to take over the assets of a bankrupt corporation may not issue debentures at 93, convertible into preferred stock at 70. *Carver* v. *Southern Iron & Steel Co.*, 78 N.J. Eq. 81.

CHAPTER II.

RIGHT OF STOCKHOLDERS TO PREVENT A SALE, OR LEASE, OF CORPORATE ASSETS.

ELYTON LAND CO. *v.* DOWDELL.

113 Ala. 177. 1896.

Bill in equity filed by Annie Dowdell, the owner of five shares in the Elyton Land Company, for the purpose of annulling a conveyance of its property by that corporation to the Elyton Company, and also of annulling a mortgage executed by the latter company to secure certain bonds

Some years before the conveyance the Elyton Land Company having on hand, as profits, a large amount of notes, had issued dividend certificates to the amount of $1200 per share. These certificates had subsequently been paid for in bonds of the company, denominated "Dividend Trust Bonds." The plaintiff had disposed of her bonds. Her rights as a bondholder are not involved in this litigation, but only her rights as a shareholder.

The Elyton Land Company, under its charter and amendments, was authorized to buy land and sell lots; to borrow and lend money; to guaranty indebtedness; to build, rent, lease, and use buildings; to issue bonds in amount not to exceed five millions of dollars; and to take stock in other corporations.

In 1893, the Elyton Company was incorporated, with authority to engage in many enterprises not included in the original or amended charter of the Elyton Land Co. The fourth section of the act incorporating the Elyton Co. enacts, "that said corporation may purchase the property, real, personal, and mixed, of the Elyton Land Company: provided that such sale is made under the laws now in force, and nothing in this act shall be construed to impair or in any manner whatsoever to affect the rights of any stockholder of the Elyton Land Company." . . .

At a regular meeting of the stockholders of the Elyton Land Company, a majority of the stockholders voted to sell its entire assets to the Elyton Company. The terms of the sale were, that the Elyton Company should pay all the liabilities of the Elyton Land Company; and issue $2,500,000 bonds, $1,796,000 of which were to be issued to the holders of the dividend trust bonds in payment thereof; and in addition issue 10 shares of its stock to each holder of 1 share of stock

in the Elyton Land Co. Thereupon the Elyton Land Company transferred all its property to the Elyton Company. The latter issued the bonds provided for, and executed a mortgage to secure them. The stipulated amount of stock was also issued, and was delivered to such of the stockholders as were willing to receive it in exchange for the stock held by them in the Elyton Land Company. No other arrangement or provision was made to pay the stockholder in the Elyton Land Company for his share, except to accept the stock in the Elyton Company. It is alleged in the bill, and not traversed in the plea, that complainant was not present, was not represented, and had no notice of the meeting of the directors of the Elyton Land Company at which it was resolved to sell its property to the Elyton Company. Immediately after the consummation of the transaction between the two corporations, complainant filed her bill.

To the bill, the respondent filed a plea and answer in support of the plea. The plea set forth the history of the "Dividend Trust Bonds"; alleged that they were valid obligations of the Elyton Land Company; and that the plaintiff, having accepted her proportion of the bonds with full knowledge of the facts, is estopped to deny that they are binding obligations of the Elyton Land Company.

The court ruled that the plea was insufficient as a defense to the bill. Appeal.

COLEMAN, J. We do not doubt the right of complainant to relief, so far as the defense is rested upon the plea. In the first place, by its charter, The Elyton Company was authorized to purchase the property of The Elyton Land Company, "provided that such sale is made under the laws now in force, and nothing in this act shall be construed to *impair*, or in any manner whatsoever to *affect* the rights of any stockholder of The Elyton Land Company." At the time of the sale and transfer of its property, The Elyton Land Company was solvent, a going corporation, and its stock was very valuable. Its duties and powers were fixed by its charter, and its business evidently managed with great skill and success, for the benefit of its shareholders. The Elyton Company by its charter was authorized to engage in many enterprises not within the scope of the powers of The Elyton Land Company. A shareholder in the latter might not be willing to become a shareholder in the other. By the sale and transfer of the property, The Elyton Land Company divested itself of all its property and capacity to continue the business for which it was organized. If the sale stands, the owner of stock in The Elyton Land Company is compelled to accept the stock of the new corporation, or hold stock in a corporation without capital assets. We lay no stress on the argument, that by its amended charter, The Elyton Land Company is authorized "to take stock" in other corporations. It was certainly never intended by that provision, to authorize The Elyton Land Company to effect its own dissolution by a sale of all its assets, and

"take the stock" of another company in payment for distribution to the shareholders or any shareholder, without the consent and contrary to the preference of the shareholder. But it is too clear for argument, that the two million shares of stock of The Elyton Company were to be issued to The Elyton Land Company, as a mere conduit to the shareholder of The Elyton Land Company, and not to be held and owned as capital assets of The Elyton Land Company. It may be that a private business corporation may sell out its entire property by and with the consent of less than all its stockholders, for the purposes of paying its debts, or for the purposes of dissolution and settlement, but when this is the purpose, it must be clearly understood, and the terms and conditions of the sale must be within the contractual relations between the corporation and its creditors or shareholders. There can be no presumption that a creditor or stockholder of the dissolved corporation will accept in payment of his demand anything but money. He cannot be required to do so arbitrarily. While the plea shows the consent and ratification of the complainant to the issue of the certificate of twelve hundred dollars to the shareholder for each share of stock, and its subsequent payment by a dividend bond, it does not show consent or ratification of the sale of the property and the execution of the mortgage. It is manifest that the whole plan of organization of The Elyton Company was in the interest of those who held the dividend bonds, without reference to the interest of the stockholder. These bonds at first maturing within three or four years were a lien or charge only upon $2,400,000 of its promissory notes, leaving all its other property unincumbered. By the arrangement, the dividend bonds, amounting to only $1,796,000, secured by a lien upon $2,400,000 of notes, were converted into gold bonds, running thirty years, and were secured by a mortgage upon all the property owned by The Elyton Land Company. The bonded indebtedness was increased over a half million dollars. The Elyton Company, from the pleading, did not own a dollar of capital other than that acquired by the purchase from The Elyton Land Company.

Decree of City Court affirmed.

NOTE. — There are numerous authorities to the effect that if the assets of a prosperous corporation are transferred to a second corporation, which is to pay for those assets with its stock and continue the business, such transfer is a wrong to any dissenting stockholder of the first corporation.

Suppose that, at the instance of a dissenting stockholder, a threatened transfer of this kind has been enjoined. Ought the injunction to be dissolved upon the corporation's giving adequate security for the payment, in cash, to the plaintiff of the value of his stock? In *Lauman* v. *Lebanon Valley R.R. Co.*, 30 Pa. 42, one railroad corpora-

tion proposed, pursuant to legislative authority, to consolidate with another railroad corporation. The court held that a dissenting stockholder was entitled to an injunction, but that this should be dissolved if the defendants secured the payment to the plaintiff of the value of his stock. See *Barnett* v. *Philadelphia Market Co.*, 218 Pa. 649. And in *Tanner* v. *Lindell Ry. Co.*, 180 Mo. 1, the court refused to set aside such a transfer, which had been made, and remitted the plaintiff to his remedy for a proportionate share of the proceeds of the sale, or for damages.

Lauman v. *Lebanon Valley R.R. Co.* sanctions, it is submitted, an exercise of the power of eminent domain without legislative authority. (There was no suggestion in the opinion of the court that the legislative sanction of the consolidation included legislative sanction of the condemnation of the interests of dissenting stockholders.)

The weight of authority is against the *Lauman case.* Thus, in *Morris* v. *Elyton Land Co.*, 125 Ala. 263 (another suit arising out of the transactions stated in the principal case), the lower court held that the relief to which the dissenting stockholder was entitled was the payment of the value of her stock in cash. The Supreme Court held that this was error. "To do so would be nothing more nor less than compelling the shareholder to sell his stock, which a court of equity has not the power to do. That it would be to the benefit of the corporation and all other shareholders in it, to let the transaction stand and compel the dissentient to accept compensation for his stock, is an argument that rests upon no higher ground than that of expediency." See, *accord, Kean* v. *Johnson*, 1 Stockton (N.J.) 401, 412; *Abbot* v. *American Hard Rubber Co.*, 33 Barb. (N.Y.) 578; *People* v. *Ballard*, 134 N.Y. 269, 295. See also *Natusch* v. *Irving*, Gow on Partnership, Appendix No. VI, p. 398, where Lord ELDON said: "The company will indemnify the plaintiff against loss by its transactions already had, or hereafter to be had, not for the specified purposes of the institution. But the right of a partner is to hold to the specified purposes his partners whilst the partnership continues, and not to rest upon indemnities with respect to what he has not contracted to engage in. A dissatisfied partner may sell his shares for double what he originally gave for them. But he cannot be compelled to part with them for that reason; it may be his principal reason for keeping them, having the partnership concern carried on according to the contract. The original contract and the loss which his partners would suffer by a dissolution, is his security that it shall be so carried on for him and them beneficially, and with augmented improvement in the value of his shares and their shares."

PHILLIPS *v.* PROVIDENCE STEAM ENGINE CO.

21 R.I. 302. 1899.

Bill in equity to restrain a sale of the property of a corporation, ordered by a vote of the majority of the stockholders, brought by a minority stockholder. The facts are stated in the opinion. Heard on bill, answer, and replication. Bill dismissed.

Stiness, J. The complainant, a stockholder, seeks to restrain the respondent corporation from disposing of its property. The company is doing business under an extension by its creditors, in the terms of which an installment becomes due in November next. It is agreed that this cannot be met, and that the company will be unable to go on in business because the creditors refuse a further extension. In view of these facts, an arrangement has been made to form a new company, in which creditors holding extension notes will take preferred stock to the extent of one-half of their claims, while other subscribers will furnish enough cash to pay for the plant and provide a working capital. The terms of the proposed sale give to the present stockholders $70,000 over and above the indebtedness of the company, amounting to about $228,000, making a total payment of about $298,000. The estimates of the value of the property vary from $327,000 to $397,000, the latter being the complainant's estimate; but it does not appear that either party has reason to expect that either sum would be realized at a forced sale. This is not a sale in which the other stockholders are to gain any advantage beyond the privilege, which is also offered to the complainant, of taking his proportionate amount of cash or its equivalent stock in the new company, as he may prefer.

It is in effect a cash sale to strangers, approved by stockholders representing 3675 shares against 75 held by the complainant. While this majority cannot affect any rights to which he is entitled, it tends to show a fair price. It is a well-known result, to which courts of justice cannot be blind, that large plants of this kind are often, if not usually, sold at a great sacrifice in case of a forced sale. We should not have to go outside of the records of our own court to find proof of this fact. A sale being necessary, the question is how shall it be made. The prayer of the bill is that a receiver may be appointed; that the business may be wound up and the company dissolved; and the argument is that the sale of the effects should be at public auction.

The question, then, is whether the complainant is entitled to such a decree.

There is a difference of opinion as to the power of a corporation to sell its entire property and thus practically to retire from business. Some courts hold that it may be done by the consent of all the stockholders (Am. & Eng. Ency. L. 2 ed. vol. 7, p. 734, note 1), and others hold that it may be done by a majority. *Ditto*, notes 2, 3, and 4. All

of the authorities cited in note 1, however, do not hold that the consent of all the stockholders is necessary, e.g., *Treadwell* v. *Salisbury*, 7 Gray, 393; *Wilson* v. *Miers*, 100 Eng. Com. Law, 248, *et al.* But the editor adds: "There seems to be no doubt that it may do so when it is no longer able to profitably continue its business."

We think that this is the correct rule. It has been recognized in this State. *Hodges* v. *N.E. Screw Co.*, 1 R.I. 312, 350. In *Wilson* v. *Prop'rs Central Bridge*, 9 R.I. 590, BRAYTON, C.J., said: "No case has been cited, and, in view of the diligence of counsel in this case, we may say there is no case which holds that where the purpose of the incorporation could not be accomplished, the business contemplated could not be carried on; where the capital had been exhausted in endeavors to go on, having no means to go further; a company thus laboring under burdens which they could no longer bear, could not release themselves by a surrender of their franchise to the State which granted and which was willing to receive it, and that by a majority. This is not only for their benefit, but it is a necessity, and it would be hard indeed if one stockholder could by his dissent prevent such relief against the prayer of all other members of the company." In *Peabody* v. *Westerly Water Works*, 20 R.I. 176, a necessary limitation to this rule was recognized in the words: "The action of the company was taken by a vote of more than 1100 out of a total of 1350 shares. There is no proof of unfairness, oppression, or fraud in such action. The case as presented is simply that of a stockholder who differs from a large majority of his fellow stockholders as to the expediency of a sale."

The principle upon which these cases rest is that a corporation may dispose of its property by a majority vote, in cases which are free from unfairness, oppression, and fraud. Against wrongs of this kind equity will interfere. To this effect are *Lauman* v. *Lebanon R.R.*, 30 Pa. St. 42; *Treadwell* v. *Salisbury*, 7 Gray, 393; *Leathers* v. *Janney*, 41 La. Ann. 1120; *Sewell* v. *East Cape May Co.*, 50 N.J. Eq. 717; *Sargent* v. *Webster*, 13 Met. 497; *Warfield* v. *Marshall*, 72 Ia. 666; *Wilson* v. *Miers*, 100 Eng. Com. Law, 348; see also *Miner's Ditch Co.* v. *Zellerbach*, 37 Cal. 543.

The complainant does not charge improper conduct, but simply that he considers the price inadequate and unjust; and hence he prays for a receiver and a sale of the property by auction. Ordinarily when a court orders a sale it can only be done by auction. A court cannot negotiate a private sale, and it orders an auction as the fairest chance for all parties to bid and buy. But when the parties in interest have negotiated a sale which is fair to all concerned, and there is nothing to show that a larger price may reasonably be expected, it does not follow that an auction sale would be ordered. This question was considered in *Quidnick Co.* v. *Chafee*, 13 R.I. 402, in which the trustee had an offer for the entire property, approved by nearly all the cred-

itors. Then other parties intervened, agreeing to bid the amount named at auction, and the court ordered a sale by auction. In the present case there is no evidence that anybody is willing to give as much as the offer proposed, or that there is any reason to suppose that it will bring as much or more. The only testimony put in by the complainant is that the tools will probably bring more than they are valued at by the company, while as to the bulk of the property, the real estate, etc., there is no evidence of market value. Moreover, the complainant does not show that he desires to bid upon the property himself, or that he knows of any one who would bid at a sale. In this absence of evidence that a larger total might be expected from an auction sale we see no reason to disturb the agreement already made, which, upon the testimony given, seems to be fair.

The complainant relies strongly on *Mason* v. *Pewabic Co.*, 133 U.S. 50. In that case the court had appointed a master to value the property, which he reported to be nearly $500,000. A majority of the company had arranged a sale to themselves at $50,000. Naturally, in view of such gross inadequacy, the court ordered a sale by auction. The case was very different in its details from the case before us.

In *Wilson* v. *Prop'rs Central Bridge*, 9 R.I. 590, the city of Providence had control of the corporation and had sold the corporate property to itself. The court restrained the city from taking possession and ordered a sale by auction. That, too, was a different case from this one.

The court is bound to look to the interests of all parties, and especially to protect the rights of a minority from oppression and fraud. But where, as in this case, no such thing is charged, and nothing is shown to lead to the belief of a better total price, the complainant makes no case for interference. To show that movable tools may be sold at a price somewhat, but not largely, higher than that at which they are scheduled, is quite a different thing from showing that the plant as a whole would sell for more than the price offered. To set aside the sale under these circumstances would be to risk a certainty for an uncertainty, without any testimony on which to base a hope of benefit to the stockholders from such interference. We see no reason for such a step in the dark. *Bill dismissed.*

NOTE. — There are numerous authorities, *accord.* As to dissolution, see *Arents* v. *Durham Co.*, 101 Fed. 338.

In *Treadwell* v. *Salisbury Mfg. Co.*, 7 Gray (Mass.) 393, it was proposed to convey the real estate of the defendant to a second corporation at a specified price, payable in the stock of the second corporation. The evidence tended to prove (p. 398) that this step was part of a plan made necessary by the financial difficulties of the defendant. BIGELOW, J., said: "We entertain no doubt of the right of a corporation, established solely for trading and manufacturing pur-

poses, by a vote of the majority of their stockholders, to wind up their affairs and close their business, if in the exercise of a sound discretion they deem it expedient so to do. At common law, the right of corporations, acting by a majority of their stockholders, to sell their property is absolute, and is not limited as to objects, circumstances or quantity. Angell & Ames on Corp. § 127 *& seq.*; 2 Kent Com. (6th ed.) 280; *Mayor, etc., of Colchester* v. *Lowton*, 1 Ves. & B. 226, 240, 244. *Binney's case*, 2 Bland, 142. To this general rule there are many exceptions, arising from the nature of particular corporations, the purposes for which they were created, and the duties and liabilities imposed on them by their charters. Corporations established for objects *quasi* public, such as railway, canal and turnpike corporations, to which the right of eminent domain and other large privileges are granted in order to enable them to accommodate the public, may fall within the exception; as also charitable and religious bodies, in the administration of whose affairs the community or some portion of it has an interest to see that their corporate duties are properly discharged. Such corporations may perhaps be restrained from alienating their property, and compelled to appropriate it to specific uses, by *mandamus* or other proper process. But it is not so with corporations of a private character, established solely for trading and manufacturing purposes. Neither the public nor the legislature have any direct interest in their business or its management. These are committed solely to the stockholders, who have a pecuniary stake in the proper conduct of their affairs. By accepting a charter, they do not undertake to carry on the business for which they are incorporated, indefinitely, and without any regard to the condition of their corporate property. Public policy does not require them to go on at a loss. On the contrary, it would seem very clearly for the public welfare, as well as for the interest of the stockholders, that they should cease to transact business as soon as, in the exercise of a sound judgment, it is found that it cannot be prudently continued. If this be not so, we do not see that any limit could be put to the business of a trading corporation, short of the entire loss or destruction of the corporate property. The stockholders could be compelled to carry it on until it came to actual insolvency. . . . Upon the facts found in the case before us, we see no reason to doubt that the vote of the majority of the stockholders, for the sale of the corporate property, and the closing of the business of the corporation, was justified by the condition of their affairs. Without available capital, and without the means of procuring it, the further prosecution of their business would be unprofitable, if not impracticable. Under these circumstances it was in furtherance of the purposes of the corporation, to pay their debts, close their affairs and settle with their stockholders on terms most advantageous to them. *Sargent* v. *Webster*, 13 Met. 504. Nor can we see anything in the proposed sale to a new corporation, and

the receipt of their stock in payment, which makes the transaction illegal. It is not a sale by a trustee to himself, for his own benefit; but it is a sale to another corporation for the benefit and with the consent of the *cestuis que trust,* the old stockholders. The new stock is taken in lieu of money, to be distributed among those stockholders who are willing to receive it, or to be converted into money by those who do not desire to retain it."

In *Maben* v. *Gulf Coal Co.,* 173 Ala. 259, the court upheld a transfer of substantially all the assets of the corporation, although it did not appear that this transfer was made necessary by the financial condition of the corporation. The court relied on *Treadwell* v. *Salisbury Mfg. Co.,* and did not mention the *Elyton cases, supra.*

In *Tanner* v. *Lindell Ry. Co.,* 180 Mo. 1, the court said (p. 24): "It is said that if the corporation is doing business at a loss the majority may close it out. But suppose it is not running at an actual loss, yet at a profit so small that in the judgment of the majority the capital invested is not yielding what it should, and from a business standpoint it should be diverted into a channel that promises better results, is there no discretion lodged in the majority to act in such emergency?" The company was earning a dividend of five per cent per annum. If this line of reasoning is sound, it undermines *Elyton Land Co.* v. *Dowdell,* and similar authorities. Transfers of the assets of solvent corporations (if not made for any fraudulent purpose) are made because the majority believe that thereby their profits will be increased. The question remains whether an attempt to increase the profits by such a transfer is permitted by the compact between the stockholders. It is to be noted that no court has yet held that there is a discretion lodged in the majority to change the purposes of the corporation when that "promises better results," so that the action of the majority binds the minority.

MASON *v.* PEWABIC MINING CO.

133 U.S. 50. 1890.

THE Pewabic Mining Company was about to be dissolved. The holders of a majority of the stock approved the transfer of its assets to a new corporation for $50,000, the stockholders in the old corporation to be entitled, at their option, to their *pro rata* share of the stock of the new corporation, or their *pro rata* share, in cash, in the value of the assets transferred, such value being taken to be $50,000.

Minority stockholders sought to enjoin the sale. A special master was appointed, who found the value of the assets to be nearly $500,000. The Circuit Court directed that the property be sold at public auction for cash to the highest bidder.

Mr. Justice Miller. With regard to the main question, the power of the directors and of the majority of the corporation to sell all of the assets and property of the Pewabic Mining Company to the new corporation under the existing circumstances of this case, we concur with the Circuit Court. It is earnestly argued that the majority of the stockholders — such a relatively large majority in interest — have a right to control in this matter, especially as the corporation exists for no other purpose but that of winding up its affairs, and that, therefore, the majority should control in determining what is for the interest of the whole, and as to the best manner of effecting this object. It is further said that in the present case the dissenting stockholders are not compelled to enter into a new corporation with a new set of corporators, but have their option, if they do not choose to do this, to receive the value of their stock in money.

It seems to us that there are two insurmountable objections to this view of the subject. The first of these is that the estimate of the value of the property which is to be transferred to the new corporation and the new set of stockholders is an arbitrary estimate made by this majority, and without any power on the part of the dissenting stockholders to take part, or to exercise any influence, in making this estimate. They are therefore reduced to the proposition that they must go into this new company, however much they may be convinced that it is not likely to be successful, or whatever other objections they may have to becoming members of that corporation, or they must receive for the property which they have in the old company a sum which is fixed by those who are buying them out. The injustice of this needs no comment. If this be established as a principle to govern the winding up of dissolving corporations, it places any unhappy minority, as regards the interest which they have in such corporation, under the absolute control of a majority, who may themselves, as in this case, constitute the new company, and become the purchasers of all the assets of the old company at their own valuation.

The other objection is that there is no superior right in two or three men in the old company, who may hold a preponderance of the stock, to acquire an absolute control of the whole of it, in the way which may be to their interest, or which they may think to be for the interest of the whole. So far as any legal right is concerned, the minority of the stockholders has as much authority to say to the majority as the majority has to say to them, "We have formed a new company to conduct the business of this old corporation, and we have fixed the value of the shares of the old corporation. We propose to take the whole of it and pay you for your shares at that valuation, unless you come into the new corporation, taking shares in it in payment of your shares in the old one." When the proposition is thus presented, in the light of an offer made by a very small minority to a

very large majority who object to it, the injustice of the proposition is readily seen; yet we know of no reason or authority why those holding a majority of the stock can place a value upon it at which a dissenting minority must sell or do something else which they think is against their interest, more than a minority can do.

We do not see that the rights of the parties in regard to the assets of this corporation differ from those of a partnership on its dissolution, and on that subject Lindley on Partnership says, Book 3, chap. 10, § 6, sub-div. 4, p. 555, original edition: "In the absence of a special agreement to the contrary, the right of each partner on a dissolution is to have the partnership property converted into money by a *sale*, even though a sale may not be necessary to the payment of debts. This mode of ascertaining the value of the partnership effects is adopted by courts of equity, unless some other course can be followed consistently with the agreement between the partners, and even where the partners have provided that their shares shall be ascertained in some other way; still, if owing to any circumstance their agreement in this respect cannot be carried out, or if their agreement does not extend to the event which has in fact arisen, realization of the property by a sale is the only alternative which a court of equity can adopt." . . .

We do not say that there may not be circumstances presented to a court of chancery, which is winding up a dissolved corporation and distributing its assets, that will justify a decree ascertaining their value, or the value of certain parts of them, and making a distribution to partners or shareholders on that basis; but this is not the general rule by which the property in such cases is disposed of in the absence of an agreement.

NOTE. — It is probably law that a stockholder cannot be required to accept anything but cash or its equivalent for his interest in the corporation, even if a sale of the corporate assets is made because the corporation is in financial difficulties. See *People* v. *Anglo-American Ass'n*, 60 N.Y. App. Div. 389.

But there would seem to be no objection to a sale of the assets to a new corporation *at a fair price* to be paid by the new corporation in its stock at par, or cash, at the option of the old stockholders. See *Slattery* v. *Greater New Orleans Co.*, 128 La. 871; *Treadwell* v. *Salisbury Mfg. Co.*, *supra.*

The ultimate question, it is submitted, is therefore this: is the plan of reorganization proposed by the majority such that a sale at auction for cash may be dispensed with without unfairness to the minority?

SMALL v. MINNEAPOLIS ELECTRO-MATRIX CO.

45 Minn. 264. 1891.

DICKINSON, J. The Minneapolis Electro-Matrix Company is a Minnesota corporation, of which the plaintiff, and the several individual defendants who have answered in this action, are the stockholders and directors. The American Electro-Matrix Company is a foreign corporation, organized and existing under the general laws of the state of New Jersey. For the sake of brevity, the former corporation will be hereafter designated as the "Minneapolis Company" and the latter as the "American Company." The case is here on appeal by the Minneapolis Company and the individual defendants above referred to, from an order refusing to dissolve a temporary injunction. Speaking comprehensively, it may be said that the injunction restrained the Minneapolis Company and the individual defendants, its directors and stockholders, from carrying into effect a resolution of the board of directors, which, as set forth in the answers of the appellants, was as follows: —

"Resolved, that the directors of the Minneapolis Electro-Matrix Company recommend to the stockholders of the company the adoption of the following proposition from the American Electro-Matrix Company: 'That the Minneapolis Electro-Matrix Company lease for twenty-five years whatever rights and property of every description it has under the laws of Minnesota a right to lease, to the American Electro-Matrix Company, a corporation organized under the laws of the state of New Jersey, upon the following terms, namely: The American Electro-Matrix Company shall assume and pay all indebtedness of this company, and meet all obligations arising under any contracts made by it; shall furnish all capital that may be required for the prompt prosecution of its patent applications, interferences or other suits, for the speedy development of its business in this country, for the negotiation of franchises in foreign countries on the best possible terms, and for the manufacture of machines in the most speedy and perfect manner; shall bring into the direction and practical management men of high reputation and business experience, and shall enlist in the different states the active co-operation of efficient men, through organization of franchise companies or otherwise if more desirable arrangements for the interests of this company can be made; and shall pay to the Minneapolis Electro-Matrix Company one-half of the net receipts from all sources, after deducting all expenditures under the provisions of this lease.'

"Resolved, that T. C. Bates, Erastus Wiman, and C. W. Davison be a committee to prepare, in conference with the American Electro-Matrix Company, and with the advice of Duncan, Curtis & Page, on behalf of this company, a lease in accordance with the above terms,

to be executed on behalf of this company by its officers, upon the approval of the stockholders at a meeting hereby called to be held at Minneapolis."

After the adoption of these resolutions, a meeting of the stockholders was called to take action upon this matter. By the injunction, as subsequently modified, the Minneapolis Company and its directors were restrained from executing a lease or transfer of its franchises or property to the American Company, and the stockholders were enjoined from voting to ratify any such lease or transfer; but it was expressly provided that the corporation should not be thereby prohibited from carrying on its ordinary and lawful business through its board of directors and its officers in its accustomed, usual, and lawful manner, retaining to itself the control and management of its affairs.

The facts bearing upon the propriety of the injunction are disclosed only so far as they are set forth in the pleadings. The precise purposes for which the Minneapolis Company was organized are not stated in the pleadings of either party. The facts are disclosed, however, that the corporation owns valuable patents for a new system of printing, which it purchased by the issue of the entire amount of its authorized capital stock, — $1,000,000; and the answers of the defendants justify the inference that the proper business of the corporation consisted in part, if not principally, in the construction of machines or apparatus for printing, under such patents, and in introducing them into use by others so as to derive a royalty therefrom. But however this may be, and whatever may have been the particular nature and scope of the purposes for which this organization was effected, we are of the opinion that the learned judges of the district court were right in considering the acts to which the injunction was directed as being a violation of the legal rights of the plaintiff as a stockholder of the corporation, in that the carrying into effect of what was contemplated in these resolutions would have been substantially a surrender and transfer of the property and business of the Minneapolis Company to another and foreign corporation, not for the purposes of winding up the affairs of the former, and distributing its property to those who would in that event be entitled to it, but in order that the business which this corporation was organized to prosecute might be for the period named carried on by the foreign corporation, in consideration of a percentage of the proceeds of the business to be paid by it. That such was the purpose contemplated seems very apparent from the terms of the resolution above recited. It is to be assumed from the pleadings and from the resolution itself that this corporation was organized for the purpose of carrying on some business, whatever its precise nature may have been, and the resolution discloses the purpose that for the period of twenty-five years such business should *not* be conducted by the Min-

nesota corporation, but that it *should* be taken up and carried on solely by the American Company. As justifying these conclusions, it is only necessary that attention be directed to the facts that the transfer of rights and property is to be for the period of twenty-five years; that the American Company is to assume and pay all the debts and perform all the contract obligations of the Minneapolis Company; to furnish the capital for the prosecution of the patent applications of the domestic corporation, for the conduct of its suits, *the speedy development of its business*, for the negotiation of franchises, the manufacture of machines; and to pay to the Minnesota corporation, whose continued existence is plainly contemplated, a specified percentage of the proceeds of the business. Other provisions, recited above, but not here again referred to, go to support the conclusions announced.

We need not inquire how far, or under what circumstances, considerations of public policy and of the general interests of the state may affect the right of a corporation to discontinue the business for which it was created, and to surrender to another corporation its property and the conduct of such business. We do decide that such a surrender of the property, and, so far as possible, of the functions, of a corporation, in order that, while it is to still continue in existence, its business may be carried on by another corporation, to which such transfer is made, would violate the rights of a non-assenting stockholder arising from the contract implied, if not expressed, in the creation of such an organization; and he would be entitled to have such acts restrained by injunction. *Stewart* v. *Erie & Western Trans. Co.*, 17 Minn. 348 (372, 398); Cook, Stocks, §§ 667, 668; 1 Mor. Priv. Corp., §§ 413, 416; *Black* v. *Delaware, etc., Canal Co.*, 24 N.J. Eq. 455; *Zabriskie* v. *Hackensack & N.Y. R. Co.*, 18 N.J. Eq. 178; *Abbot* v. *Am. Hard Rubber Co.*, 33 Barb. 578; *Middlesex R. Co.* v. *Boston & Chelsea R. Co.*, 115 Mass. 347. In the absence of express provision to the contrary, it is to be considered as the law concerning business corporations that their affairs are to be managed in the interest of their stockholders, and by directors or agents appointed by them. This is to be taken to be implied in the contract, unless in some manner a different intention is expressed. It is not to be inferred from the pleadings in this case, even if such a thing be possible, that the original purposes of this corporation may have included the project of surrendering its business to some other corporation, to be carried on for a period of years by the latter, under the direction and control of *its* officers and stockholders, the stockholders of the company thus transferring its business having no voice in the selection of such officers nor in the management of the business. If in fact the contract involved in the corporate organization did express any such extraordinary purpose as the committing of the business and interests of this company to the sole management and control of strangers

to this corporation and its stockholders, for a period of twenty-five years, we think that it was incumbent upon the defendants, upon this motion to dissolve the injunction, to show that fact by presenting the articles of incorporation.

Order affirmed.

NOTE. — See, *accord*, *Parsons* v. *Tacoma Smelting Co.*, 25 Wash. 492, and cases cited.

A fortiori, a stockholder may object to a lease by a public service corporation, not sanctioned by the legislature. See *Dow* v. *Northern R.R. Co.*, 67 N.H. 1; *Oregon Ry. Co.* v. *Oregonian Ry. Co., Ltd.*, 130 U.S. 1.

BARTHOLOMEW *v.* DERBY RUBBER CO.

69 Conn. 521. 1897.

SUIT by minority stockholders of a manufacturing corporation, to compel the surrender and cancellation of a lease of its plant to Loewenthal. The directors voted to make the lease, and gave notice of a special stockholders' meeting to confirm their action. The action of the directors was approved by all the stockholders present at the meeting.

The term of the lease thus confirmed was for one year, with a privilege upon the part of the lessee to renew the lease from year to year, for a period not exceeding nine years, upon the same rent and conditions. The lease also provided that at the expiration of any year the lessee might purchase the property if he chose, at a price to be determined upon by an appraisal made in conformity to the mode therein designated.

The respondents demurred to the complaint.

ANDREWS, C.J. The plaintiffs are a minority of the stockholders of the Derby Rubber Company. They ask that a certain contract called a lease, between the said company and the other defendants, be set aside and declared to be void. The record shows that this contract was made by the directors of the company; that it was, before delivery, submitted to a meeting of the stockholders duly called for that purpose, and that by a unanimous vote of the stockholders present at that meeting and holding a majority of all the stock, it was affirmed and ratified. The plaintiffs, although duly notified of said meeting and the purposes for which it was to be held, voluntarily remained away.

If the contract was really *ultra vires* of the corporation, the plaintiffs may claim that it should be set aside. The contract contains an option to the lessee to become the purchaser of the property at a price

to be fixed by a sort of arbitration. The complaint avers that it is the intention of the directors and the majority stockholders, in case the option is used, to divide the money received among all the stockholders and wind up the affairs of the corporation. As a conditional contract to sell the property, this agreement is not questioned; nor could it well be questioned. It is competent for any business corporation to sell its property, pay its debts, divide its assets and wind up its affairs. Especially is this so if the corporation is in an embarrassed condition. It is as a lease for ten years without a sale, that the contract is said to be *ultra vires*. We speak of the contract hereafter as a lease. The sole question then is: Was the vote ratifying the lease, and so the lease itself, *ultra vires* and void?

We are inclined to think the lease was not void. The lessee is to continue the same business which the corporation was organized to carry on. The lease, therefore, is not a change in the business, but only a change in the management of the business. The financial condition of the corporation is now depressed, and its business cannot be made profitable under its own management, for want of capital. Additional capital is not available. But neither the directors nor the majority stockholders have so far lost confidence in the concern as to be willing peremptorily to wind up its affairs. The lease was entered into as the best, perhaps the only, means of carrying the corporation over this period of depression, and in the meantime obtaining some income for the stockholders. If a sale take place it is certain that the property will be worth more in operation than if left idle. Such leases have repeatedly been sustained by the courts of equity. . . .

We have considered this case on the assumption that the action of the directors and the majority stockholders was done in good faith and in the honest belief that they served the best interests of all concerned. If fraud had been charged a very different case would have been presented.

NOTE. — In *Parsons* v. *Tacoma Smelting Co.*, 25 Wash. 492, the defendant contended that the lease in question was justified by financial difficulties, but the court refused, on the facts, to support the contention.

On the other hand there are cases where the court has held that a lease was proper, even though the corporation was not in financial difficulties. See *Hennessy* v. *Muhleman*, 40 N.Y. App. Div. 175 (lease for development of mineral lands); *Starke* v. *Guffey Petroleum Co.*, 98 Tex. 542 (same. Lease for 20 years).

RIKER & SON CO. *v.* UNITED DRUG CO.

79 N.J. Eq. 580. 1911.

GUMMERE, C.J. This is an appeal from an order denying a preliminary injunction restraining the defendant, its officers, directors, tellers and inspectors from submitting to the stockholders of the company a proposition to take action upon a resolution of the board of directors providing that the defendant corporation should be dissolved, and prohibiting them from passing any resolution or receiving or counting any votes in favor of any resolution designed to carry into effect or accomplish any proposition to dissolve the said company.

The United Drug Company is a New Jersey corporation. The proposed dissolution is a step in the carrying into execution of a plan formulated by the board of directors of the company for its "reorganization," and outlined by the board in a communication, sent by it to the several stockholders of the company upon the same day that a resolution was passed by it, reciting that, in the judgment of the board, it was for the benefit of the corporation that it should be forthwith dissolved and that a meeting of the stockholders should be held to take action upon that resolution.

The material parts of the resolution (so far as the matter before us is concerned) are as follows: "To the stockholders of the United Drug Company. Your directors have had under consideration for some time the desirability of a reorganization of the affairs of the United Drug Company. They have had in mind, among other things, the accomplishment of the following results — first, owing to the remarkable increase in the business of the company, it is necessary to provide not only for additional capital to meet its immediate requirements, but also to put the company on such a basis that it can obtain from time to time in the future such additional capital as may be needed; second, . . . ; third, a substantial part of the business of the company is now conducted by the United Laboratories Company, the United Perfume Company, the United Candy Company and the United Stationery Company, all subsidiary corporations of the parent company. It is proposed to eliminate these subsidiary companies, to place the ownership of all these in one corporation, and obtain greater simplicity in accounting, and to some extent eliminate an unnecessary duplication of expense. With the approval of your directors, therefore, the following plan for the reorganization of the affairs of the United Drug Company has been proposed: Your directors have authorized the organization of a corporation under the laws of Massachusetts by the name of United Drug Company. . . . The United Drug Company (of Massachusetts) has offered to purchase all the property and assets of the United Drug Company (of

New Jersey), subject to all its indebtedness, and to pay therefor as follows": viz., by delivering to the holders of stock of the New Jersey corporation in exchange for that stock shares of the stock of the Massachusetts corporation. The communication then concludes thus: "Your directors unanimously recommend the acceptance of the proposed plan of reorganization, and pending action by the New Jersey Company recommend an immediate exchange of the stock of the New Jersey company for stock of the Massachusetts company in accordance with the terms of the offer. If for any reason it should become either necessary or desirable to delay the dissolution of the New Jersey corporation and the transfer of its assets, or even to continue its corporate existence, the practical accomplishment of the plan would not be affected, as the Massachusetts corporation would by the exchange become the controlling stockholder of the New Jersey corporation."

Manifestly, the prime purpose of the scheme outlined in this communication is not the winding up of the New Jersey corporation and the distribution of its assets, or the proceeds of the sale thereof, among its stockholders, but the absorption of that company by the Massachusetts corporation, the transfer not only of its assets but of its business, to that corporation, and the future carrying on of that business by the Massachusetts corporation under the name of the defendant company. The scheme, in its essence, whatever it may be in form, is not a plan for the reorganization of the New Jersey company, nor even for the winding up of its business and its dissolution within the meaning of the latter word as used by our Corporation Act, but is a scheme for its merger into or consolidation with the Massachusetts corporation. *State* v. *Atlantic City and Shore Railroad Co.*, 77 N.J. Law (48 Vr.) 466, 483.

Consequently, the fundamental question now to be decided is whether a corporation of this State, organized under our General Corporation Act, may legally be merged into or consolidated with a corporation created by and organized under the laws of a sister State. The answer to this question seems to us not to be in doubt. As was said by this court in *Colgate* v. *United States Leather Co.*, 75 N.J. Eq. (5 Buch.) 229, the power of corporations to consolidate and merge is not to be implied, and exists only by virtue of plain legislative enactment; and no statute of our State can be found which authorizes the proposed scheme. The only right given, by our legislature, to two or more corporations to merge or consolidate into a single corporation, is expressly limited to those which are organized under the laws of our own State. Revised Corporation Act, § 104; P. L. 1896, p. 309. The proposed plan for the so-called "reorganization" of the defendant company is, therefore, in violation of the law of the State whose creature it is; and, this being so, any stockholder who refuses to consent thereto is entitled to the aid of a court of

equity to prevent its being carried into execution. Each stockholder of the company owns a share in its property and assets, and is entitled to have a proportionate share in its profits. They have invested their capital in it, and in it alone, and they are entitled to every dollar that it earns. This is the agreement of the stockholders among themselves. They each contract with the other that their money shall be employed for the purposes specified in the certificate of incorporation, and for no other purpose, and that the profits of the enterprise shall be ratably apportioned among them. In the absence of legislation permitting a variation of the provisions of this fundamental contract, by vote of a majority of the stockholders, no majority, however large, has a right to divert any part of the joint capital, however small, to any purpose not consistent with and growing out of this original, fundamental agreement. *Black* v. *Delaware and Raritan Canal Co.*, 24 N.J. Eq. (9 C. E. Gr.) 456, 463; *Mills* v. *Central Railroad Co. of New Jersey*, 41 N.J. Eq. (14 Stew.) 1; *Colgate* v. *United States Leather Co.*, *supra.*

The scheme, in the carrying out of which the dissolution of the company is a proposed step, is a fraud upon the statute (the word is used in a legal, not a moral sense); and every act done in furtherance thereof, no matter whether it be legal, standing alone, or not, is equally a fraud upon the statute. This being so, the complainants were entitled to an injunction to restrain the proposed invasion of their rights under the contract of incorporation, as soon as it was made manifest that such invasion was in fact contemplated.

The order denying the preliminary injunction will be reversed and the case remitted to the court of chancery, with a direction that an injunction do issue restraining the defendant company, its officers and directors, from submitting to its stockholders for action thereon by them the resolution of the board of directors of the company advising its dissolution.

NOTE. — *People* v. *Ballard*, 134 N.Y. 269. A business corporation cannot sell all of its property to a foreign corporation, organized through its procurement with a majority of non-resident trustees, for the purpose of taking its place and its assets and carrying on its business; as this is a practical dissolution of the corporation.

Theis v. *Spokane Falls Co.*, 34 Wash. 23. By statute a corporation might be dissolved upon the vote of the holders of two-thirds of the stock. Held, that this authorized a dissolution only upon the *bona fide* intent of the stockholders to discontinue the business. If the dissolution is made that the property may be sold to, and the business carried on by, a new corporation controlled by the majority stockholders, any single stockholder is entitled to restrain (and to set aside, if consummated) the sale of the corporate assets made in such dissolution proceedings.

MATTER OF TIMMIS.

200 N.Y. 177. 1910.

APPEAL from an order of the Appellate Division of the Supreme Court in the second judicial department, entered July 29, 1910, which affirmed an order of Special Term directing an appraisal of the stock of the petitioner pursuant to section 17 of article 2 of the Stock Corporation Law.

The Sackett & Wilhelms Company is a domestic corporation organized to carry on the business of lithographing and printing. In August, 1909, at a meeting of its stockholders, held pursuant to notice, a resolution was adopted by the votes of the holders of more than two-thirds of the capital stock, authorizing the board of directors to "sell the good-will, business, assets and property of what is known as its Calendar Department, the same being and constituting a separately conducted department of its business, upon such terms and for such consideration" as the directors should prescribe. The respondent, who owned forty shares of preferred stock and thirty-five of common, voted against the resolution, and within twenty days after the meeting served a notice objecting to the sale and demanding payment for his stock, "pursuant to the provisions of the Stock Corporation Law." As the demand was not complied with, upon a petition showing these facts among others, he moved at Special Term on due notice for the appointment of appraisers, and that he be paid for his stock the amount of the appraisal thereof, when made.

Upon the hearing before the Special Term it appeared that the business of the calendar department was to obtain orders and create a demand for calendars and other advertising specialties through traveling salesmen; to secure designs and plates for the decoration thereof; to procure the same to be lithographed and printed by the regular department of the company, accounting for the work at current rates and to sell the same through its salesmen; that it did no printing or lithographing; that the sales of the calendar department, which has always been separately conducted and the accounts thereof separately kept, amounted to about one-thirteenth of the entire business of the corporation; that the successful conduct of the department required the continued use of a large amount of capital which the corporation was unable to provide; that the business, assets and good-will comprised among other things pictures, plates, finished calendars, contracts with salesmen of calendars and the good-will of buyers of calendars; that a corporation known as the Robert Chapman Company had been organized with power to "acquire, as a going concern," the calendar business of the Sackett & Wilhelms Company, and the terms of sale required the purchaser to give all the printing and lithographing to the parent company at

current rates for the period of ten years; that the purchase price was to be $20,000 in cash, all the common stock amounting to $150,000 and $60,000 of the entire issue of $300,000 of preferred stock.

The motion was granted, appraisers were appointed and the court further ordered that within ten days after their report "the said Sackett & Wilhelms Company pay in cash to the petitioner the value of his stock as estimated and certified by said appraisers and that thereupon the petitioner surrender the certificates for said shares to said company for cancellation." The corporation appealed from the order of the Special Term to the Appellate Division and from the order of affirmance by that court to the Court of Appeals.

VANN, J. This appeal involves the construction of sections 16 and 17 of the Stock Corporation Law. Section 16, which is entitled "Voluntary sale of franchise and property," provides that "A stock corporation . . . with the consent of two-thirds of its stock, may sell and convey its property, rights, privileges and franchises, or any interest therein or any part thereof to a domestic corporation, engaged in a business of the same general character . . . and such sale and conveyance shall, in case of a sale to a domestic corporation, vest the rights, property and franchises thereby transferred . . . in the corporation to which they are conveyed for the term of its corporate existence. . . . Before such sale or conveyance shall be made such consent shall be obtained at a meeting of the stockholders called upon like notice as that required for an annual meeting." The provisions authorizing a sale of property only to a foreign corporation are not now material.

Section 17, entitled, "Rights of non-consenting stockholders on voluntary sale of franchise and property," provides that "If any stockholder not voting in favor of such proposed sale or conveyance shall at such meeting, or within twenty days thereafter, object to such sale, and demand payment for his stock, he may, within sixty days after such meeting, apply to the Supreme Court . . . for the appointment of three persons to appraise the value of such stock, and the court shall appoint three such appraisers, and . . . also direct the manner in which payment for such stock shall be made to such stockholder. . . . When the corporation shall have paid the amount of such appraisal, as directed by the court, such stockholder shall cease to have any interest in such stock and in the corporate property of such corporation and such stock may be held or disposed of by such corporation." (Stock Corporation Law [L. 1909, chap. 61], §§ 16 and 17; Consolidated Laws, chap. 59, §§ 16 and 17.)

The appellant claims that the sale of the calendar department is in the line of its ordinary business; that it is a lawful corporate act regardless of section 16 and that it did not give to the dissenting stockholder the rights created by section 17.

The substance of the sections in question was first enacted by

chapter 638 of the Laws of 1893, probably to meet the situation as it was left by a line of judicial decisions ending in 1892. The valuable opinion of Judge ALLEN in *Abbot* v. *American Hard Rubber Co.* (33 Barb. 578), after standing the test of time and criticism for thirty years, was followed by *People* v. *Ballard* (134 N.Y. 269). These cases and those which intervened established the law that a corporation cannot sell all its property, or even a part thereof so integral as to be essential for the transaction of its ordinary business, because such a sale is wholly or partly an act of self-destruction and a practical dissolution without compliance with law.

The discussion of the subject in the various opinions suggested two evils: (1) The injustice to the bulk of the stockholders from want of power in a corporation to sell its business or an essential part thereof to another corporation organized for the purpose, frequently from its own membership, on terms deemed advantageous by the holders of a large majority of the stock. (2) The injustice to minority stockholders of requiring them to abandon, change or limit their business if the majority should have the power to direct such a sale. An incidental evil was the power of a dissenting stockholder to compel the majority to buy him out on his own terms in order to secure unanimous consent with no one left to question the transaction.

These evils could be remedied only by legislation, for the courts cannot provide against inherent defects in the creation of corporations. The Act of 1893 is reproduced and amplified by sections 16 and 17 of the statute now in force. This legislation was designed to meet the evils pointed out by the courts by enabling a majority of two-thirds to sell if they deemed it was the best policy, and at the same time to protect the minority, if they regarded the sale as opposed to their interests. The situation when the original act was passed points to the purpose of the legislature and throws light on the meaning of the words used to express its intention. Notwithstanding the broad language of section 16, it is obvious that it was not addressed to ordinary sales by a corporation, nor even to those extraordinary in size but still in the regular line of its business, for such sales would have been valid without amending the Stock Corporation Law. We are not now called upon to lay down a rule embracing all the cases covered by the statute, but simply to decide whether the facts of this case bring it within the sections under consideration.

The sale before us was not made in the ordinary course of the business of the corporation, for it was not organized to sell calendar departments, or any department that would involve going out of business *pro tanto*. It was not a sale of calendars over the counter or on the road, but of the "business assets and property," including the good-will, of an independent and important branch of its business, and the large price agreed upon indicates the actual value of what

was sold. The parent company lacked capital to carry on the department, and, as the learned counsel for the appellant states, "the sale was a business necessity," which implies that it was not in the ordinary course. By the sale of the good-will the corporation would be prevented from ever engaging in that kind of business again, and while not in form a sale of its franchise to that extent, it would be in effect, because it could no longer exercise its franchise to make and sell calendars. One of the powers conferred by the charter would thus be parted with, and the right to carry on a line of business authorized by the law of its being would be permanently gone. It could not do a kind of business duly authorized by its charter as it had before. As an arm of a living man may become paralyzed and useless, so an arm of the appellant would become paralyzed and useless by such a sale as the one described. As the living arm could no longer lift, or touch, or exercise its cunning, so the arm of the artificial being could no longer make calendars, or sell them, or enter into contracts relating thereto. Its own action would result in complete paralysis of every power required to conduct a calendar department, and to this extent it would go out of business. Such a sale would, therefore, be corporate suicide to a certain extent, and to that extent a sale or abandonment of the charter. While a natural person may do anything within the limits of his physical and mental capacity not forbidden by law, an artificial person can do nothing except as authorized by law. The sale in question would not be valid without resorting to section 16, and by resorting to that section the appellant opened the door for the respondent to enter and demand his rights under section 17. The claim that the earlier section was not invoked by specific mention in the notice calling a meeting of stockholders to authorize the sale, is met by the statement therein that "under the charter of the corporation the calendar department cannot be transferred to a separate corporation without the authorization of the holders of two-thirds of the capital stock." While this did not refer directly to the Stock Corporation Law, it did indirectly, for every statute which adds to or takes from the power of a corporation is a part of its charter.

As the appellant availed itself of the privilege conferred by the statute, it must comply with the condition prescribed for the exercise thereof.

The order appealed from should be affirmed, with costs.

CULLEN, Ch.J., GRAY, HAIGHT, WERNER, WILLARD BARTLETT and CHASE, JJ., concur.

Order affirmed.

NOTE. — See Mass. Laws of 1903, chap. 437, §§ 40 and 44.

Koehler v. *St. Mary's Brewing Co.*, 228 Pa. 648. Although by the Act of 1876, P. L. 30, § 5, the holders of the majority of the stock

of specified corporations may cause all its property to be sold to other corporations, this act is not to be construed to require any dissenting stockholder to accept anything but cash or its equivalent for his interest.

COTTON *v.* IMPERIAL CORPORATION.

[1892.] 3 Ch. 454.

The Imperial and Foreign Agency and Investment Corporation, hereinafter called the Old Company, was formed in 1889. The capital consisted of founders' shares, preferred shares, and deferred shares.

The memorandum of association stated that the object of the company, amongst other things, was (S) to sell, lease, or otherwise dispose of the company's undertaking, or any part thereof, or any property, or interest in property, from time to time belonging to the company, for such consideration as the company might think fit; and in particular for shares, stock, obligations, debentures, debenture stock, scrip, or securities of any company; and (T) to divide any shares, stock, bonds, obligations, debenture stock, scrip, or securities belonging to the company among the members in specie.

It having been deemed expedient to wind up the company, an extraordinary general meeting of the company was held on the 13th of April, 1892, at which a resolution was passed approving of the sale and transfer of the undertakings of the Old Company to a New Company, to be incorporated for the purpose, under the same name with the word *New* prefixed, in accordance with the terms of a draft agreement submitted to the meeting. On the same 13th of April, at the same meeting, a special resolution was proposed for the voluntary winding up of the Old Company and for the appointment of two liquidators; but such resolution was lost.

On the 2d of May, 1892, the agreement between the Old Company and the New Company was executed for the sale and transfer of the Old Company's undertaking to the New Company, in consideration of the allotment to the Old Company of fully paid-up shares in the New Company.

At an extraordinary general meeting of the Old Company, held on the 4th of May, 1892, a special resolution was passed for the voluntary winding-up of that company and the appointment of two liquidators; and on the 25th of May, at another extraordinary general meeting, the resolution passed at the meeting of the 4th of May was confirmed, and it was resolved that the liquidators should be authorized to divide among the members of the Old Company, so far as possible, the paid-up shares receivable under the agreement of the 2d of May, 1892.

The plaintiff was the holder of founders' shares as well as other shares.

In July, 1892, the plaintiff took out a summons in the winding-up of the Old Company, before Mr. Justice VAUGHAN WILLIAMS, asking that it might be declared that he was entitled to compel the liquidators to purchase the shares and all other (if any) the interest held by or belonging to him in the Old Company, at a price to be determined in accordance with the provisions of §§ 161 and 162 of the Companies Act, 1862, and that the liquidators might be restrained from transferring the assets of the Old Company to the New Company, when his Lordship held, that the transaction did not come within the 161st section, and was of opinion that if the plaintiff had any remedy it was by an action to set aside the agreement.

The plaintiff thereupon commenced this action on behalf of himself and all other the shareholders in the Old Company, asking that it might be declared that the agreement of the 2d of May, 1892, was *ultra vires* the Old Company; and for an injunction to restrain such company and the liquidators from proceeding to carry the agreement into effect; or, in the alternative, for a declaration that the plaintiff and all other dissentient shareholders of the Old Company were entitled to require the liquidators either to abstain from carrying the agreement into effect or to purchase the interest held by them at a price to be determined in manner prescribed by § 161 of the Companies Act, 1862; [1] and to restrain the liquidators from dealing with the assets of the Old Company without providing for the payment of the amount due to them in respect of the purchase of such interest.

The plaintiff now moved in the terms of his writ.

[1] 25 & 26 Vict. chap. 89, § 161: "Where any company is proposed to be or is in the course of being wound up altogether voluntarily, and the whole or a portion of its business or property is proposed to be transferred or sold to another company, the liquidators of the first-mentioned company may, with the sanction of a special resolution of the company by whom they were appointed, conferring either a general authority on the liquidators, or an authority in respect of any particular arrangement, receive in compensation or in part compensation for such transfer or sale shares, policies, or other like interests in such other company, for the purpose of distribution amongst the members of the company being wound up, or may enter into any other arrangement whereby the members of the company being wound up may, in lieu of receiving cash, shares, policies, or other like interests, or in addition thereto, participate in the profits of or receive any other benefits from the purchasing company; and any sale made or arrangement entered into by the liquidators in pursuance of this section shall be binding on the members of the company being wound up; subject to this proviso, that if any member of the company being wound up who has not voted in favour of the special resolution passed by the company of which he is a member at either of the meetings held for passing the same expresses his dissent from any such special resolution in writing addressed to the liquidators or one of them, and left at the registered office of the company not later than seven days after the date of the meeting at which such special resolution was passed, such dissentient member may require the liquidators to do one of the following things as the liquidators may prefer; that is to say, either to abstain from carrying such resolution into effect, or to purchase the interest held by such dissentient member at a price to be determined in manner hereinafter mentioned, such purchase-money to be paid before the company is dissolved, and to be raised by the liquidators in such manner as may be determined by special resolution."

CHITTY, J. The motion is to restrain the Old Company, in which the plaintiff is a shareholder, and the liquidators of that company, from proceeding to carry into effect the agreement of the 2d of May, 1892. That agreement was entered into between the Old Company and a New Company which has the same name, with the addition of the word "New," and who are also defendants.

In the memorandum of association of the Old Company there is the usual clause stating the objects for which the company is established, and they are numerous; but I need only to refer to that one under the letter "S." [His Lordship read the clause as set out above.]

Now it is said that the power which is thus taken by the company to itself, and assented to by all the persons who were or were to become members of the company, is *ultra vires;* and I have been at a loss to understand from the beginning of the argument to the present moment how that can be. The company might have for one of its objects the buying and working of an hotel, and it buys the hotel and works it, but it takes power in its memorandum of association to sell the whole of its undertaking. That is a good power. It can sell the hotel, and, when it has got the money, the money will have to be dealt with according to the constitution of the company. Instead of selling for money, this company by its memorandum says that the sale may be for shares in another company. I see nothing unlawful in that whatever. I am really at a loss to know how to put the argument, because, when the shares in the other company are thus acquired through the medium of a sale, these shares become the property of the selling company, and have to be dealt with according to the constitution of that company. In the memorandum before me, there is under the letter "T" power to divide the shares, debenture stock, and securities belonging to the company among the members in specie. I am not concerned with that power at the present moment; but it shews that the Old Company contemplated selling, as it clearly did, for shares, and dividing them among the members. Of course, that must be subject to all the rights of the members as defined by the memorandum and articles of association. They must divide the shares and the other securities mentioned if they take them upon the sale according to the rights of the members *inter se;* but they may clearly, in my opinion, take, as the consideration for the sale, shares in another company. That being so, it was necessary, in conformity with clause S, which provided that the consideration was to be such as the company might think fit, that there should be a meeting of the Old Company to determine whether they would take shares as a consideration for a sale. A meeting was duly convened and held, and a resolution was passed, the effect of which was that the directors were authorized by the company to enter into the agreement of the 2d of May, 1892. It is in substance an agreement for the trans-

fer of the whole of its undertaking by the Old Company to the New Company, the consideration being shares.

In my opinion what has been done by the directors is authorized by the memorandum, and by the resolution of the company acting in pursuance of the memorandum.

Now, it certainly is the case that when the directors proposed the resolution in regard to this sale for shares to the meeting they also proposed that there should be a winding-up, which proposition was, however, not carried, while the other was. Afterwards the directors thought it would still be advisable to wind up if the shareholders were of that opinion; and subsequent meetings were held, and the result was that a resolution was passed to wind up voluntarily.

These latter facts form another ground upon which the argument in support of this motion is based. It is said that now the 161st section of the Act of 1862 is brought in, and that inasmuch as there was at the time when the first resolution was carried, a proposal before the meeting to wind up, the resolution as to the sale was *ultra vires* because the clause in the memorandum of association was rendered void by the 161st section. With great respect to those who put the argument before the Court, it seems to me that that is extravagant.

This was a good resolution when it was passed, and it is contrary to the settled decisions upon the construction of Acts of Parliament to go upon a "tendency." You must find that the thing which is done, and which is said to be void, is, when the Act of Parliament is properly understood, a violation of the Act: *Jeffries* v. *Alexander*, 8 H.L.C. 594; *Philpott* v. *St. George's Hospital*, 6 H.L.C. 338.

The 161st section is in substance this — when there is a winding-up, whether voluntarily or by the Court or under supervision, the duty of the liquidators under the Act of Parliament is to turn all the assets of the company into money, and, having paid the creditors and the costs of the winding-up, then to distribute among the members according to their equities the surplus, if there be any. Then it was seen that there were many cases in which a company might wind itself up voluntarily or the like merely for the purpose of reconstruction, and that it would be very advantageous that there should be taken a power in substance for the company to reconstruct itself. That was one of the objects that was sought to be accomplished by the 161st section; but the gist of the enactment is this — that the liquidators in a winding-up, instead of selling for money, may sell for shares; but, as a safeguard against that, and against imposing possibly a liability upon a member of the company which is being wound up by seeking to force upon him shares which were not fully paid up, the Legislature has, by way of protecting his interest, said in substance that if he dissents he may receive the value of his shares in money. That is, in short, an explanation of the meaning and effect of the 161st section. It relates to what may be done where

there is a winding-up; and although the section commences with the words, "Where any company is proposed to be . . . wound up," the result is plain that the power is only conferred upon the liquidator.

Now, I take this clause, and endeavour to apply it to the power in the memorandum. The company has sold its undertaking for shares in another company. What then? This 161st section may still have an operation upon the shares which have thus been taken as the consideration. I can see no inconsistency in saying that the liquidators, if otherwise duly authorized according to the 161st section, might actually sell the shares which they take from the new company, they being part of the assets of the old, and sell them to some other company on the terms of their taking shares in that other company. I can see therefore upon this short statement no inconsistency between the 161st section and the power taken by the memorandum of association. There is no prohibition in the 161st section. It is a power conferred upon the liquidators for the more convenient winding-up of a company, and it is not a violation of anything to be found in that section for a company, by its own memorandum of association, to take power to sell its assets for shares in another company, and even if it should think fit (because this would be the agreement of all the members of the company) to divide in specie among the shareholders the shares which have been thus acquired.

NOTE. — See also, *Republican Mines, Ltd.*, v. *Brown*, 58 Fed. 644, 650.

Traer v. *Lucas Prospecting Co.*, 124 Iowa, 107. Although minority stockholders dissent, a prosperous corporation may sell all its property for stock in another corporation, if its articles of incorporation, taken in connection with the law under which the organization takes place, authorize such transfer. "When a person becomes a shareholder in a corporation, he assents to the transaction of the business expressly or impliedly authorized by the charter; and therefore, if the charter authorizes the sale or other disposition of all its property, he cannot complain."

See also *Maben* v. *Gulf Coal Co.*, 173 Ala. 259, 261, 265.

SCHWAB *v.* POTTER CO.

194 N.Y. 409. 1909.

APPEAL, by permission, from an order of the Appellate Division of the Supreme Court in the first judicial department, entered December 11, 1908, which reversed an interlocutory judgment of Special Term overruling a demurrer to the answer and sustained such demurrer.

The case made by the complaint is substantially as follows: The defendant, "E. G. Potter Company," is a domestic corporation organized in 1905 for a purpose not disclosed, with a capital stock of $350,000, divided into 3500 shares of the par value of $100 each. Three thousand shares have been issued and are outstanding, but the remainder have not been issued.

On the 31st of December, 1907, said company owned a parcel of real estate in the city of New York known as 477 Fifth Avenue, with an office building thereon six stories in height. Said property, being all the real estate owned by the company, was subject to a mortgage thereon of $350,000, but was otherwise free from incumbrance.

On the day last named "said company, at a special meeting of its stockholders called for the purpose . . . passed a resolution" the material portions of which are as follows: "Resolved, that the board of directors of this company be and they hereby are authorized, empowered and directed to cause to be organized a corporation at the expense of this company under the laws of the State of New York, with a capital stock of $100,000, with the name 'Library Realty Company,' or such other name as may be satisfactory to the officers of this company, for the purpose of acquiring the real estate of this company, No. 477 Fifth Avenue, in consideration of the issuance to this company of all the capital stock of said new corporation; . . . That the board of directors be and they are hereby authorized, empowered and directed to transfer to said new corporation when formed, the equity in the real estate of this company known as 477 Fifth Avenue, subject to the existing mortgage thereon amounting to $350,000 and to receive in exchange for said equity in said real estate all the capital stock of said new corporation to be formed, viz.: capital stock of the par value of $100,000; . . . That the board of directors of this company be and they hereby are authorized, empowered and directed to cause the said $100,000 par value of stock of said new corporation when acquired by this company to be offered by proper notice to the stockholders of this company for subscription at par, each stockholder of this company to have the right to subscribe for an amount of the stock of the new corporation at par equal to one-third of the par value of said stockholders' holdings of this company, each stockholder not wishing to subscribe to have the right to assign his rights to so subscribe, and, in the event of failure of any stockholder or his assignee to so subscribe, his rights to subscribe to terminate and the company to have the right to receive subscriptions for all or any part of such unsubscribed for stock in the new corporation from the stockholders of this company or from outside parties, the time in which to subscribe to be limited as the directors may deem best and the said subscription to be in cash as follows . . . That the board of directors be and they hereby are authorized, empowered and directed to do or cause to be done all acts that may

be necessary, convenient or desirable in order to carry out the foregoing resolutions and to properly safeguard the rights of this company and of the stockholders to the stock of the new company."

This resolution was adopted by a vote of 2450 shares in favor as against 550 opposed, after the stockholders in attendance at the meeting had been furnished with a statement of the assets and liabilities of the company in which said real estate is valued at the sum of $498,301.90, less $350,000, the amount of the mortgage thereon. The plaintiff subsequently had the property appraised by competent and reputable real estate dealers familiar with the values of real property in the locality in question, who reported it worth the sum of $525,000, said sums being respectively $48,000 and $75,000 "in excess of the prices at which it is proposed to convey the same to the corporation."

The rest of the assets, valued at about $100,000, were described in said statement as "merchandise in store, fixtures in store, labor on contracts in progress, etc." The bills and accounts owing by the corporation amounted to $98,199.23, and while a surplus of $1,642.97 was reported, unless the equity in the real estate was worth more than $100,000, the sum at which it was proposed to sell it, there was not only no surplus, but the capital was impaired to the extent of $46,658.03.

The plaintiff was one of the original corporators of the defendant company and has owned 100 shares of its capital stock from the outset, having paid $10,000 in cash therefor. He voted and protested against the adoption of said resolution, and, alleging that $100,000 is an inadequate price for the equity in the real estate, he brought this action in behalf of himself and the other dissenting stockholders, to restrain the company, its directors and officers from taking the proposed action, upon the ground that it "is illegal and calculated to injuriously affect the rights of" the minority. The complaint contains no express allegations of fraud or bad faith. It alleges that the directors all favor the plan and that they are about to carry it into effect.

The defendants answered, and the following is a copy of their second and third separate defenses: "*Second.* That it was necessary to sell the property at said sum of $450,000, or even less, if said price could not have been obtained, to conserve the interests of the stockholders of the defendant company." "*Third.* That the agreement to sell the property pursuant to the resolution marked in the complaint 'Exhibit A,' was ratified and confirmed by stockholders representing over two-thirds of the capital stock of the company."

To these defenses the plaintiff demurred on the ground that each is insufficient in law upon the face thereof. The court at Special Term overruled the demurrer, holding that the answers were good, only because the complaint was bad, but the Appellate Division, by

a vote of three to two, reversed the interlocutory judgment and sustained the demurrer upon the ground that the complaint was good and the answers bad.

The defendants appealed to this court by permission of the Appellate Division, which certified the following question for decision: "Does the complaint state facts sufficient to constitute a cause of action?"

VANN, J. The main question presented by this appeal is whether the proposed transaction is beyond the powers of the defendant corporation, for it is well established that in the absence of fraud or bad faith courts have nothing to do with the internal management of business corporations, provided they keep within their corporate powers. (*Gamble* v. *Queens County Water Co.*, 123 N.Y. 91; *Flynn* v. *Brooklyn City R.R. Co.*, 158 N.Y. 493, 507.) Thus we said in the case last cited: "Whatever may lawfully be done by the directors or stockholders, acting through majorities prescribed by law, must of necessity be submitted to by the minority, for corporations can be conducted upon no other basis. All questions within the scope of the corporate powers which relate to the policy of administration, to the expediency of proposed measures, or to the consideration of contracts, provided it is not so grossly inadequate as to be evidence of fraud, are beyond the province of the courts. The minority directors or stockholders cannot come into court upon allegations of a want of judgment or lack of efficiency on the part of the majority and change the course of administration. Corporate elections furnish the only remedy for internal dissensions, as the majority must rule so long as it keeps within the powers conferred by the charter."

The complaint does not disclose the purposes for which the defendant corporation was organized, nor set forth its corporate powers except as it may be inferred from the statement of assets and liabilities that it carries on a manufacturing business, while the new corporation apparently was to be a "realty" company. If, however, no corporation in this state is authorized to organize another, divide its assets with it and take in exchange its entire capital stock, then the proposed plan is *ultra vires* and the execution thereof may be restrained by injunction.

Corporations are created by statute and have no powers except those conferred by statute, directly or indirectly. (L. 1892, chap. 687; L. 1895, chap. 672, § 10.) There is no statute in this state which directly authorizes one corporation to organize another and, as we think, such action is not indirectly authorized by any reasonable inference from the most extensive powers committed to any class of corporations known to our law. Corporations are organized by natural persons, acting under the direction of a statute, and they only can become corporators, directors or officers. "Artificial persons," without brain or body, existing only on paper through legislative

command and incapable of thought or action except through natural persons, cannot create other "artificial persons," and those, other still, until the line is so extended and the capital stock so duplicated and reduplicated, as to result in confusion and fraud. If, in the case before us, the proposed plan is carried into effect, the old corporation will be the only stockholder of the new corporation when it comes into being, which is the time to test its legality, and the entire capital stock of the latter will have been taken from the assets of the former. After the old corporation has thus split itself into two corporations, both together will have only the capital that the old corporation had before. Not a dollar of new capital will have been contributed either in money or property, and only when the old corporation sells to subscribers or outsiders, — and it is not alleged that it will be able to sell to either, — all or a part of the shares of stock, issued to it by the new, can any money come from the transaction. This shows that the purpose of the strange action proposed is to increase the capital stock of the old company without complying with the provisions of the statute governing the subject. The increase is to be obtained by what is in effect a forced assessment upon the full paid and non-assessable shares of the stockholders, for unless they take new stock they lose a material part of their investment, although something they do not want is given in exchange. Thus they are virtually compelled by an unlawful scheme to enter into new contractual relations with strange parties. (*Mason* v. *Pewabic Mining Co.*, 133 U.S. 50.) This would be an obvious evasion of the law which the courts will restrain when applied to by the proper party. As was well said by the presiding justice below in a useful opinion: "But it is evident from the allegations of this complaint and from the inferences that fairly may be drawn from such allegations that what was in the contemplation of the directors and majority stockholders of the defendant corporation was not to have that corporation make an actual sale of the real estate to another corporation and receive shares of stock as the consideration therefor, but to resort to a device by which to increase its capital by dismembering itself and organizing another corporation of which it should be the only stockholder, and thus evade the provisions of the statute relating to the increase of the capital stock of a corporation. The defendant corporation, by the resolution, is authorized and *directed* to create a new corporation at the expense of the old one. What it is to do, therefore, is to be a corporate act done in its capacity as a corporation. Instead of increasing its capital stock in the manner provided by law, it is to separate its assets, deliver one portion of them to its own creature, capitalize that portion at a fixed valuation, and receive back all the shares of stock issued by its creature; and there that transaction really ends. Affording an opportunity to the stockholders of the old corporation to subscribe to the stock of the new one is merely an offer to them to buy from the old

corporation this new stock after it comes into the possession of the old corporation." (129 App. Div. 36, 40.)

We cannot assume from the allegations of the complaint that the old corporation will be able to sell the shares of new stock when issued as fully paid and delivered to it. Apparently it has not been able to sell all its own stock, for five hundred shares of the amount authorized have not been issued. It is possible, therefore, that the old corporation will be compelled to permanently hold a part at least of the new shares, while the new corporation will have no individual stockholders to act as officers or directors. The law permits no such anomaly as one corporation organized by another corporation, which furnishes all its capital, takes all its shares of stock and holds them for sale. The new organization could never have a valid existence, for the disposition of the shares by the old corporation would not validate an illegal charter.

Section 40 of the Stock Corporation Law does not aid the defendants. That statute authorizes a stock corporation, if permitted by its charter, to acquire, hold and dispose of shares of stock issued by another corporation, and in any case to acquire, hold and dispose of shares of stock issued by certain classes of corporations, including those engaged in a similar business and those with which it might be consolidated. (L. 1892, chap. 688, § 40.) It does not permit one corporation to create another, endow it with capital from its own assets and take all its shares of stock in exchange. Moreover, it is not alleged in the complaint that the defendant company is authorized by its charter to acquire stock in another corporation, or that it is engaged in a business similar to that of the corporation it proposes to organize.

Corporations cannot resort to ingenious and original methods of action with the freedom of individuals, for they are confined to those expressly authorized by statute and such as are incidental thereto and necessary to carry them into effect. If the purpose of the old corporation was to increase its capital stock, the object was lawful but the method was unlawful and this is true if its object was merely to sell its real estate. Whatever the purpose may have been, the plan was unlawful, because it would have caused an increase of the capital stock of the corporation by an unauthorized method. While the majority stockholders, or the directors, acting as individuals, could have organized the new corporation, they could not use the real estate of the old corporation to provide it with capital stock, for that was not their property. According to the scheme adopted, however, the majority stockholders were not to effect the new organization, but the board of directors, acting as such, were "authorized, empowered and *directed* to cause" the new corporation to be organized, "at the expense of the old" and by a division of its assets. This was beyond the powers of the corporation, its stockholders and direc-

tors. Whatever is done by a corporation without authority is done in violation of law, for all action, not authorized directly or indirectly, is prohibited. (General Corporation Law [L. 1890, chap. 563, as amended], § 10.) Any minority stockholder who opposed the scheme was entitled to an injunction, even without alleging actual injury, or the certainty thereof in the future, for he is entitled to stand on his legal rights and may refuse to accept "something better" in exchange. His legal right was to continue a member of one corporation and not to be forced into the membership of a second corporation, all the capital of which was to be taken from the assets of the former. The plaintiff is now the equitable owner of one-thirtieth of the assets of the defendant company. By the proposed plan he will be deprived of his one-thirtieth interest in the real estate and either lose it altogether or be forced to buy stock in another company, organized without the sanction of law, in order to save himself. That would in effect be a forced sale by the corporation to its own stockholders, and would result in an increase of the capital stock by an unauthorized method.

If we have reasoned correctly thus far, it is obvious that the allegations in the second and third divisions of the answer constitute no defense. Even if a sale of the real estate was "necessary," as alleged in the second defense, that did not permit the organization of a corporation without authority, nor justify the spoliation of the defendant company in order to give it capital; and, if the agreement to sell was "ratified" by two-thirds of the stockholders, as alleged in the third defense, that did not validate the method of selling, as to any stockholder who objected. Ratification may confirm a voidable act, but not one utterly void.

We think that the complaint sets forth a good cause of action and that the answer, so far as before us, sets forth no defense.

The order appealed from should be affirmed, with costs, with leave to the defendants to plead over within twenty days on payment of costs, and the question certified answered in the affirmative.

CULLEN, Ch.J., HAIGHT, WERNER, WILLARD BARTLETT, HISCOCK and CHASE, JJ., concur.

Order affirmed.

NOTE. — Such a sale or lease as is considered in this chapter is, it is submitted, usually objectionable only because it is contrary to the compact among the stockholders. See *Farish* v. *Cieneguita Copper Co.*, 12 Ariz. 235, 239.

But it may be objectionable because the transaction is *ultra vires* the corporation, using that word in the sense stated at p. 378, *supra*. Thus, (1) of a sale or lease of the assets of a public service corporation, without legislative sanction; or (2) of a sale or lease in consideration of stock which it is *ultra vires* for the corporation to acquire.

For cases, in addition to the principal case, where the transaction was objectionable on the ground that it involved an *ultra vires* holding of stock, see *Byrne* v. *Schuyler Co.*, 65 Conn. 336; *Easun* v. *Buckeye Brewing Co.*, 51 Fed. 156.

Cf. *Holmes Mfg. Co.* v. *Holmes Metal Co.*, 127 N.Y. 252, holding that it is not *ultra vires* for a manufacturing corporation, with the consent of all its stockholders to transfer its assets for the stock of another corporation. "Inasmuch as this was done with the consent of all the stockholders, it being the act of a private corporation, not in any manner harming the public, we see no reason for condemning its title to the stock so obtained."

CHAPTER III.

RIGHTS OF CREDITORS AS AFFECTED BY REORGANIZATIONS.

EWING *v.* COMPOSITE BRAKE SHOE CO.

169 Mass. 72. 1897.

Action at law upon a contract.

Lathrop, J. The plaintiff was a creditor of a Maine corporation to the amount of $787. This corporation ceased to do business, and the stockholders, together with at least one other person, formed a new corporation with a different name under the laws of Massachusetts. The new corporation is the defendant in this case. It took all the assets of the old corporation except its books, but it did not assume to pay all of the debts of the old corporation, although there was evidence that one Whitcomb, who was the manager of both of the corporations, told the plaintiff that the new company would be liable for the debts of the old. It is obvious, however, that where a new corporation is formed, the creditors of the old corporation do not, without something further being done, become creditors of the new corporation. They have an equitable right to follow the assets of the old corporation; but they cannot maintain an action at law against the new corporation, for there is no privity of contract. To render the new corporation liable there must be a new contract made, such as will amount to a novation. See Moraw. Corp. (2d ed.) §§ 808 *et seq.*

Note. — A covenant made by a corporation will run with the land owned by the corporation when the covenant was made if, but only if, a similar covenant by a natural person would run. See Warren, Cases on Property, pp. 840 *et seq.*

But there is no rule of law, special to corporations, that corporate liabilities run with corporate assets, even if those assets are acquired as an entirety. The authorities in *accord* with the principal case are numerous.

A fortiori, the purchaser is not bound if the purchase is made at a sale in foreclosure of a mortgage upon the corporate assets. *Lake Erie Co.* v. *Griffin*, 92 Ind. 487; *Cook* v. *Detroit Ry. Co.*, 43 Mich. 349; *Smith* v. *Chicago Ry. Co.*, 18 Wis. 17.

Usually the vendee promises the vendor, in consideration of the

transfer of the assets, to discharge all the liabilities of the vendor. This promise is an asset of the vendor and may be reached in equity by the creditors of the vendor; and in many jurisdictions the creditors of the vendor may sue the vendee at law. See Wald's Pollock on Contracts (3d American edition by Williston), pp. 256 *et seq.; Hawkins* v. *Central of Georgia Ry. Co.*, 119 Ga. 159; *Harvey* v. *Milk Co.*, 92 Me. 115; *Tecumseh National Bank* v. *Saunders*, 50 Neb. 521; *Billmyer Lumber Co.* v. *Merchants Coal Co.*, 66 W.Va. 696.

NEW BEDFORD RAILROAD *v.* OLD COLONY RAILROAD.

120 Mass. 397. 1876.

Colt, J. The Statute of 1874, chap. 55, authorizes the defendant corporation "to purchase the rights, franchise and property of the Middleborough and Taunton Railroad Corporation," and gives to the latter corporation, upon such purchase, power to convey to the Old Colony Railroad Company "its franchises and property, and all the rights, easements, privileges and powers granted to it." It also declares that upon such conveyance the defendant corporation shall "have and enjoy all the rights, powers, privileges, easements, franchises and property of said Middleborough and Taunton Railroad Corporation, and be subject to all the duties, liabilities, obligations and restrictions to which said last named corporation may be subject."

This action is to recover damages for a tortious act of the Middleborough and Taunton Railroad Corporation, for which it was liable previously to the time of the purchase; and the questions raised by the demurrer are, whether the defendant is liable for that act, and, if so, whether an action can be maintained directly against it, or must be first brought against the other corporation.

The answer to these questions depends upon the intention of the Legislature, to be deduced from the terms of the statute and the manifest purpose of the act. The language is broad enough to place the defendant in all respects in the position of the other corporation, upon the conveyance and assignment provided for. It is equivalent to an amalgamation of the two; all the franchises, privileges and powers are transferred, without reservation; not merely the franchise to own and manage a railroad, but the franchise of being a body politic, with rights of succession, of acquiring, holding and conveying property, and of suing and being sued by its corporate name. It puts out of the reach of creditors all property liable to attachment to satisfy claims, either in contract or tort. It practically terminates the corporate existence of the selling corporation, except, perhaps,

so far as such existence may be necessary in order to hold and distribute the consideration received for the sale, or to meet the requirements of the statute which prolongs the life of all corporations for three years after dissolution, for the purpose of enabling them to close their concerns. Gen. Sts. chap. 68, § 36. It operates as a dissolution of the corporation by force of the statute and of the assent manifested by the sale. *Lauman* v. *Lebanon Valley Railroad*, 30 Penn. St. 42.

In view of these results, it would be a narrow construction to hold that when the statute subjects the purchasing corporation "to all the duties, liabilities, obligations and restrictions" of the other, it only intended to impose those obligations which the corporation owed the public under its charter and the laws of the Commonwealth, and that the property transferred was only that by which it served the public in the exercise of its franchise. In the absence of express provision, it cannot be inferred that it was the intention of the act to impair claims of third parties for existing liabilities, or to shorten the time within which the remedy must be pursued. The question is not whether the statute compels the creditor to accept the defendant corporation as a new debtor against his will, or an injured person to resort to a stranger for satisfaction, but whether it empowers the creditor or the person injured to resort, if he chooses, in the first instance, to the corporation which, by the terms of the statute, is made liable to him. And we are of opinion that it does, and that the privity necessary to support this action is created by the statute and the purchase and conveyance under it.

Demurrer overruled.

IRVINE *v.* NEW YORK EDISON CO.

207 N.Y. 425. 1913.

Chase, J. The Block Lighting and Power Company, No. 1, transferred its property, real and personal, including its franchises, by bill of sale to the Manhattan Lighting Company on December 13, 1898. The consideration of such transfer does not appear. The Block Company and the Manhattan Company were merged into and with the New York Gas and Electric Light, Heat and Power Company on February 1, 1900. The gas company and the Edison Electric Illuminating Company of New York were consolidated and became the defendant, The New York Edison Company, on May 20, 1901. The transactions mentioned were each independent acts, not having so far as appears any relation to one another. The plaintiff's claim is against the Block Company. The assets, if any, of the Block Company are in the possession of the defendant, expressly subject,

as will hereinafter appear, to the rights of the creditors of the Block Company.

The question in this case is reduced to a consideration of the plaintiff's remedy. Can the plaintiff maintain this action as one of debt against the defendant? I think not, and I concur in the opinion written by Justice McLaughlin in the court below.

The legislature has provided two ways of uniting two or more corporations by transfer of their property to a single corporation. One statute provides that "Any two or more corporations organized under the laws of this state for the purpose of carrying on any kind of business of the same or of a similar nature" which a corporation organized under the Business Corporations Law might carry on, may consolidate such corporations into a single corporation. (Business Corporations Law, § 7 [Cons. Laws, chap. 4]. See, also, §§ 7 to 11 inclusive; former Business Corporations Laws [Laws of 1890, chap. 567], §§ 8 to 12 inclusive, as amended prior to 1909.)

Another statute provides that "Any domestic stock corporation and any foreign stock corporation authorized to do business in this state lawfully owning all the stock of any other stock corporation organized for, or engaged in business similar or incidental to that of the possessor corporation may file in the office of the secretary of state, under its common seal, a certificate of such ownership, and of the resolution of its board of directors to merge such other corporation, and thereupon it shall acquire and become, and be possessed of all the estate, property, rights, privileges and franchises of such other corporation, and they shall vest in and be held and enjoyed by it as fully and entirely and without change or diminution as the same were before held and enjoyed by such other corporation, and be managed and controlled by the board of directors of such possessor corporation, and in its name, but without prejudice to any liabilities of such other corporation or the rights of any creditors thereof. . . ." (Stock Corporation Law, § 15 [Cons. Laws, chap. 59]; former Stock Corporation Law [Laws of 1890, chap. 564], § 58, as amended prior to 1909.)

It is also provided in the Transportation Corporations Law (Laws of 1909, chap. 219, § 61 subd. 3 [Cons. Laws, chap. 63]) that "subject to the permission and approval of the proper public service commission, any two or more corporations organized under this article or under any general or special law of the state for the purpose of carrying on any business which a corporation organized under this article might carry on, may consolidate such corporations into a single corporation, and any such corporation may with the like permission and approval be merged with any other such corporation, upon complying with the provisions of the Business Corporations Law relating to the consolidation of business corporations and the Stock Corporation Law relating to the merger of stock corporations."

The Transportation Corporations Law thus expressly recognizes the right of corporations to consolidate under the Business Corporations Law, and also to merge under the Stock Corporation Law. Each form of procedure is independent of the other. Where a consolidation is consummated pursuant to the statute it is expressly provided that the rights of creditors of any corporation that shall be so consolidated shall not in any manner be impaired, and also "such new corporation shall succeed to and be held liable to pay and discharge all such debts and liabilities of each of the corporations consolidated in the same manner as if such new corporation had itself incurred the obligation or liability to pay such debt or damages." (Cons. Laws, chap. 4, § 11.)

If the gas company was liable for the indebtedness to the plaintiff described in the complaint, the action will lie against the defendant therefor because of the statute quoted. Whether the gas company became liable for the debts of the Block Company depends upon the statute, pursuant to which the merger took place. In the statute authorizing a merger of corporations, there is no provision making the possessor corporation liable for the debts of the corporation merged. It is expressly provided in that statute that the merging of corporations shall be "without prejudice to any liabilities of such other corporation or the rights of any creditors thereof."

This reservation of the rights of creditors permits them to proceed against the debtor corporation, notwithstanding such corporation is merged into another. The rights of creditors include the right to sue the debtor corporation and to take the property which was of the debtor corporation by execution issued upon a judgment obtained against such debtor. Such right rests upon the express terms of the statute and does not necessarily depend, as has been suggested, upon the existence and a finding of a fraudulent transfer.

This court has recently considered the effect of a merger of banking corporations. (*Matter of Bergdorf*, 206 N.Y. 309.) Upon a merger of banking corporations (Banking Law [Cons. Laws, chap. 2], §§ 36 to 40 inclusive) it is expressly provided that the corporation into which they are merged shall "be held liable to pay and discharge all such debts and liabilities, and to perform all such trusts of the merged corporation in the same manner as if such corporation into which the other shall become merged had itself incurred the obligation or liability." But it is provided by the statute that no "action or other proceeding then pending before any court or tribunal in which any corporation that may be merged is a party shall be deemed to have abated or discontinued by reason of any such merger, but the same may be prosecuted to final judgment in the same manner as if the said corporation had not entered into the said agreement."

This court, in considering the effect of a merger in the *Bergdorf*

case, say: "It could not have taken place without statutory authority and the legislature *fixed the indisputable and exclusive effects of it.* (*People* v. *N.Y., Chicago & St. Louis R.R. Co.*, 129 N.Y. 474.)"

Referring again to the statutory provisions under which the merger was consummated, the court further say: "Those statutory provisions state plainly the effects of the merger of the Morton Company into the Guaranty Company. The former company became (with the nominal exception hereinafter stated) rightless, propertyless and powerless; and the latter company was enlarged by the absorption of all that the former surrendered. . . . But the Morton Company did not surrender its corporate existence. It was not dissolved. It remained a corporation, but for the single purpose and with the sole power of being sued or proceeded against upon and defending against causes of action alleged to exist against it at the time of the merger. All the other powers bestowed upon it and which were evidenced by its certificate of incorporation and the statute law relating to it were by the merger transferred to the Guaranty Company. A corporation may exist though it possesses no property. A corporation may have a partial as well as a total extinction, and a legislature may enact that the merged corporation shall be extinguished by the merger, except in so far as the statute shall keep it nominally alive for a specified purpose. Our conclusion is that the Morton Trust Company does not exist within or as a part of the Guaranty Company, and the two are not identical. As a legal being, a corporate entity, it retained the one activity and power, and otherwise is non-existent" (p. 315).

The language of the court in the *Bergdorf case* is applicable to this case. The Block Company never existed within the gas company, and does not exist within or as a part of the defendant. Although the Block Company has become extinct, its corporate existence is retained for the one purpose of carrying out in good faith the reservation in the statute of the rights of the creditors thereof. We repeat that for that purpose the Block Company can be sued. The plaintiff after obtaining judgment against the Block Company may, by execution or otherwise, reach the assets of such company as though the merger had never taken place.

The provisions of the merger statute and of the consolidation statute were considered together by the legislature in 1890, and they have since been considered by it from time to time. There would seem to be little or no objection and much reason for making a corporation which takes all of the assets of other corporations by consolidation or merger liable for the indebtedness of such consolidated or merged corporations. The acceptance of such property could be made an assent to such liability. The whole matter was, however, clearly before the legislature for its consideration, and it was considered by it, and it made a corporation accepting the assets of

other corporations under the statute authorizing the consolidation of corporations liable for the indebtedness of the corporations so consolidated. It declined so to do in the case of corporations transferring assets under the merger statute. The rights of creditors were not overlooked, as the legislature expressly provided that the rights of such creditors should be preserved and that the merger should be without prejudice as to them.

In view of the history of the acts referred to it must be assumed that the omission to make the possessor company directly liable for the debts of the merged corporations was intentional. The courts should not attempt to supplement the legislative provision relating to the creditors of the merged corporations by making the possessor company liable as upon contract for the indebtedness of such companies, either wholly or to the extent of the property transferred to it, particularly in view of the fact that it appears that the subject has been fully considered and acted upon by the legislature itself.

The reservation by the legislature of the rights of creditors negatives the suggestion that a transfer in pursuance of the statute would be a crime. Such a transfer is not one made "with intent to defraud prior or subsequent purchasers, or to hinder, delay or defraud creditors or other persons" within the meaning of § 1170 of the Code of Criminal Procedure.

If the property of the Block Company is not of such a nature that it can be reached directly by execution or otherwise, it constitutes a trust fund for the benefit of such creditors and can be reached as such precisely as if a merger of the Block Company had never taken place.

The rule in equity is that as between *cestui que trust* and trustee, and all parties claiming under the trustee otherwise than by purchase for a valuable consideration, without notice, all property belonging to a trust, however much it may be changed or altered in its nature or character, and all the fruit of such property, whether in its original or altered state, continues to be subject to or affected by the trust. (*Matter of Hicks*, 170 N.Y. 195.)

A creditor of a corporation has the right to follow the assets of a corporation and appropriate the property by due process of law, including any property which has been changed, provided the trust fund can be clearly ascertained, traced and identified. (*Matter of Hicks, supra.*)

In my view the objection to sustaining the action now before us may be summarized by stating that the defendant has never contracted directly or by inference to pay the debts of the Block Company; and the statute, which is the authority for the transfer of the property, if any, from the Block Company to the gas company, does not provide that the possessor company shall assume the indebted-

ness of the merged company, but expressly provides that the rights of creditors of the merged company are preserved. The statute was not carelessly drawn and the omission to make the possessor company liable for the debts of the merged company was not an oversight.

COLE *v.* MILLERTON IRON CO.

133 N.Y. 164. 1892.

APPEAL from order of the General Term of the Supreme Court in the second judicial department, made May 12, 1891, which reversed a judgment in favor of defendants, entered upon a decision of the court on trial at Special Term, and granted a new trial.

This action was brought by plaintiff, a judgment creditor of the National Mining Company of Pawling, to set aside a conveyance made by it of all its property to defendant, the Millerton Iron Company, and also to release said property from the lien of a mortgage executed by that company to defendant, the Mercantile Trust Company, and for the appointment of a receiver, etc.

FINCH, J. The plaintiff is a creditor of the National Mining Company, a corporation formed and existing under the laws of this state. He commenced an action to recover damages done to his property by the wrongful act of the corporation, serving the summons in October, 1887, and recovering judgment in July of the next year. During the pendency of the action all the property and assets of the debtor corporation were transferred to the Millerton Iron Company, also a domestic corporation, upon a nominal consideration, except an assumption by the vendee of the debts of the vendor, and thereupon the former executed a mortgage to the Mercantile Trust Company covering all its property, including that acquired from the National Mining Company. When the plaintiff obtained his judgment nothing remained upon which it was a lien and his execution was returned unsatisfied. He then began this action, in which he assailed the transfers made, with a view of subjecting the property of the debtor corporation to the satisfaction of his debt. Upon the trial his complaint was dismissed, but the General Term reversed the judgment and ordered a new trial. From that order the Trust Co. alone appeals and has given the usual stipulation for judgment absolute.

The trial court has refused to find that the National Company was insolvent at the date of its transfer, but did find that such transfer suspended and terminated the regular business of the grantor, and was made and accepted with that purpose and intention. The practical effect was to dissolve the grantor corporation and subject its charter to forfeiture at the hands of the state, for it voluntarily stripped itself of all its property and assets and became incapable,

and intended to be and remain incapable of performing its corporate duties. Such a transfer, which involves the destruction of the corporation and an abandonment of the purposes of its organization, is illegal as against creditors whose rights are thereby sacrificed and their remedies destroyed. The transfer was illegal also because made in contemplation of insolvency. Those who accomplished it knew that its necessary and inevitable effect would be to make the corporation unable to pay its debts and must be held to have intended that consequence of their acts. I do not agree to that reading of the statute which limits its prohibition to cases in which payment of some note or obligation has been previously refused. An interpretation so narrow would seriously maim and distort the obvious purpose of the statute and make a transfer, in contemplation of insolvency, good the day before a note matured and bad the day after. As against the creditor the transfer to the Millerton Company was illegal and in fraud of his rights. The assets of a corporation are a trust fund for the payment of its debts upon which the creditors have an equitable lien both as against the stockholders and all transferees, except those purchasing in good faith and for value. (*Bartlett* v. *Drew*, 57 N.Y. 587; *Brum* v. *Ins. Co.*, 16 Fed. Rep. 143; Morawetz on Corporations, § 791.) The Millerton Company was not such a purchaser. It parted with nothing. It knew and participated in the illegal purpose to destroy the National Company, to make it utterly insolvent, and to deprive its creditors of the trust fund upon which they had a right to rely, and so they were at liberty to set aside the transfer so far as it barred their remedy, and to enforce their equitable lien upon the property in the hands of the transferee.

It is not a sufficient answer to say that the transfer was rather formal than real, because before its occurrence the Millerton Company, having the same stockholders and officers, managed and conducted the business of the National Company before the transfer, as well as after, and that what occurred was a practical consolidation. Companies may consolidate, but under the permission and safeguards of the statute, all of which were disregarded, and what is called the formal transaction cuts off and destroys the right of the creditor, and is being used for that exact purpose.

Neither is it an answer to say that the creditor is not harmed by a change of the party liable to pay, unless there be some disproportion in the assets. He cannot be forced to change his debtor against his will, and it appears in the proof that the transfer to the Millerton Company was followed by a mortgage sweeping in to its lien and peril the very property transferred.

The rights of the mortgagee, who is the present appellant, need not now be accurately determined. Whether that mortgage was valid at all for want of proper consents, or whether any of the bondholders have acquired equities superior to those of the plaintiff, may

or may not become questions in the future. Enough appears to show that some of them do not stand in the attitude of *bona fide* creditors, and that the remedies of all may be confined to the property of the Millerton Company not derived from the National, until at least the former is exhausted. Those questions, however, may be left to the developments consequent upon further proceedings.

The order of the General Term should be affirmed and judgment absolute for the plaintiff be rendered upon the stipulation, with costs. All concur. *Order affirmed and judgment accordingly.*

NOTE. — It is plain that the assets of a corporation should not pass to the stockholders (except as dividends properly declared and paid) until the creditors have been satisfied or protected.

If stockholders of a corporation cause its assets to be transferred to a new corporation organized by them, the stock of which is issued in payment thereof to the old stockholders, the new corporation should be liable, to the extent of the value of the assets received, to any creditor of the old corporation. *San Francisco R.R. Co.* v. *Bee*, 48 Cal. 398; *Hancock* v. *Holbrook*, 40 La. Ann. 53. It is not necessary to disregard the corporate fiction to reach this result. Cf. *Bank* v. *Trebein*, p. 125, *supra*, and the note thereto. Usually the corporation would be chargeable with knowledge that it was participating in an act which was a wrong to creditors. If the case can be imagined where the new corporation would not be chargeable with notice, it might well be held that the issue of stock, which had no value except as it represented an interest in the assets transferred, did not constitute a purchase for value.

If all the assets of a corporation are transferred to a second corporation having other assets, and the vendee issues its stock for such assets directly to the old stockholders, and is chargeable with notice that there are creditors of the old corporation, it has participated in a wrong to those creditors, and should be liable to them to the extent of the value of the assets received. *Luedecke* v. *Des Moines Co.*, 140 Iowa, 223; *Grenell* v. *Detroit Gas Co.*, 112 Mich. 70; *Hurd* v. *New York Laundry Co.*, 167 N.Y. 89.

If all the assets are transferred to a second corporation having other assets, and the vendee issues its stock for such assets directly to the old stockholders, it is submitted that the vendee should be exposed to the liability stated in the preceding paragraph, even if it was not chargeable with notice that there were creditors of the old corporation. The second corporation knows that it is participating in an act which will embarrass such creditors as there may be. See *Camden Ry. Co.* v. *Lee*, 84 S.W. (Ky.) 332; *Grenell* v. *Detroit Gas Co.*, 112 Mich. 70, 72; *Railway Co.* v. *Catar*, 103 Miss. 616; *Cooper* v. *Light & Power Co.*, 35 Utah, 570, 591; *Tacoma Ledger Co.* v. *Western Home Ass'n*, 37 Wash. 467.

If the second corporation purchases all the stock of the first corporation, and then causes the assets of the first corporation to be transferred without any consideration paid therefor to the first corporation, the same result should follow. *Standard Distilling Co.* v. *Coal Co.*, 239 Ill. 600. But there is a regrettable decision to the contrary. *Hageman* v. *Railroads*, 202 Mo. 249.

If all the assets of a corporation are transferred for a consideration paid into the corporate treasury, is the purchaser liable to the creditors of the corporation, who, as it turns out, cannot collect their judgments from the corporation because the proceeds of the sale have been improperly divided among the stockholders without providing for creditors? In *Standard Distilling Co.* v. *Coal Co.*, 239 Ill. 600, the court said (p. 605): "The Company might rightfully discontinue its business and dispose of its assets and property and a purchaser dealing in good faith and paying for the property with money or other property would not assume any liability." But what constitutes acting in good faith toward creditors, known or unknown? If it is improper for the purchaser to pay the consideration directly to the stockholders, it would seem also to be improper for him to pay it to the corporation where he has notice that the corporation is to act as a mere conduit, and that the consideration is forthwith to be divided up among the stockholders. It is suggested that a purchaser, who is unwilling to assume the liabilities of the old corporation, should not only pay the consideration into the corporate treasury, but should also make it a condition of the purchase that the old corporation should be forthwith dissolved. In dissolution proceedings the rights of all creditors would be protected.

The law on this point is not clear.

PENNSYLVANIA TRANSPORTATION COMPANY'S APPEAL.

101 Pa. 576. 1882.

MR. JUSTICE MERCUR. This bill prays for a decree that the Pittsburgh, Titusville & Buffalo Railway Company shall pay to the appellant a certain judgment which the latter holds against the Oil Creek & Allegheny River Railway Company. The claim against the appellee is based mainly on the following facts.

In 1868, under certain agreements and an Act of Assembly, the Farmers' Railroad Company, the Warren & Franklin Railroad Company, and the Oil Creek Railroad Company were consolidated, and the new corporation took the name of "Oil Creek & Allegheny River Railway Company."

In 1874 the mortgage indebtedness of the three several corpora-

tions, resting on their property prior to the consolidation, aggregated more than two and a half millions of dollars; and the consolidated company had executed a mortgage on the whole property for more than one million of dollars. With this load of indebtedness, exceeding three and a half millions of dollars resting on its property, the Oil Creek & Allegheny River Railway Company on the 1st of May, 1874, made default in payment of the interest due on its consolidated mortgage. In July following a receiver was placed in possession of the property of the company. Soon thereafter a bill was filed for a foreclosure of the mortgage, and a decree therefor made. This was afterwards set aside for want of jurisdiction. In July, 1875, a bill was filed in the United States Circuit Court against the Oil Creek and Allegheny River Railway Company for a foreclosure of the consolidated mortgage. In September following upon full hearing of the bill and answer a decree was made for the sale of all the railroad property and its franchises. The sale was made, and in January, 1876, was duly confirmed. Afterwards and pursuant to law the persons, for whose benefit the property was purchased, proceeded and erected themselves into a new corporation under the name of the "Pittsburgh, Titusville & Buffalo Railway Company," which is the appellee in this case. The Oil Creek and Allegheny River Railway Company was indebted to the appellant before the decree for a sale of the property was made; but no judgment therefor was recovered until April thereafter. After the sale was decreed, but before it was made, the appellant as a creditor presented its petition to the court and asked to intervene, and that the decree of sale be vacated; but the court refused to allow the intervention. The master found as a fact that in that petition the appellant "did set up and charge more fully than in the present bill the fraudulent purpose of the default and sale," but it was dismissed, and the specific grounds of that judgment are not shown. On the hearing in the present case before the master, it was urged that the default in the payment of interest on the 1st of May, 1874, was not *bona fide*, but fraudulent, and that the default and sale were brought about with intent to defraud the appellant. The master found "that these facts are nowhere charged in the bill and are not sufficiently shown by the testimony." He further found that three months after the default, certain of the bondholders held a meeting at which it was resolved to take measures to foreclose the mortgage and sell the road.

It is conceded that if the sale was fair and valid, it passed the property to the purchasers discharged from all claim of the appellant thereon. The argument is that a certain written agreement, entered into between the purchasers before the sale, changed the effect thereof — in substance that it operated as a fraud on the appellant.

It was entered into between the bondholders, all of the stockholders, and by most of the unsecured creditors entitled to sign by the

terms of the agreement. It recited the default of the company in paying interest and the threatened sale of its property, and then declared, for the protection of their several and respective interests in the property from great loss and sacrifice, they desired to unite together for the purpose of bidding on the property, should the same be offered for sale, and of purchasing it for and on their respective accounts, as therein more particularly stated, and to organize a new company. It proceeded, *inter alia*, to classify the parties to the contract according to the nature of their several claims, and stated the sum each should pay towards the purchase of the property, and the character of the bonds that the bondholders should be entitled to in the corporation to be formed, and the shares of capital stock therein to which each should be entitled.

What then was there illegal or invalid in so agreeing? It was not to depress the property or cause it to be sold for a sum less than its value but to enhance it. It has been held that bondholders may unite for the purchase of the property: *Ketchum* v. *Duncan*, 6 Otto, 659; *Sage* v. *R.R. Co.*, 9 id. 342. It is a fair and wise course for them to pursue, to prevent a sacrifice of their property. If they may so unite, we see no valid reason why stockholders may not unite with them, in a purchase at a sale made in good faith. They as well as bondholders are interested in protecting their property from sacrifice, and may resort to like lawful means to protect it. So, when an agreement was made between a railroad company, its bondholders and most of its creditors, whereby the property of the company was to be sold under judicial process and a new company organized in which the bondholders were to have a like amount of new bonds, and the stockholders and general creditors take new stock, in the absence of actual fraud, it was held that the new company duly organized took title to the property purchased clear of incumbrances and equities existing against the old company: *Smith* v. *Chicago & North-Western R.R. Co.*, 18 Wis. 17. In that case there was an agreement to sell and work the conversion. In the present case the agreement was merely contingent on a sale occurring. The property of the corporation was about to be sold at a judicial sale on a mortgage executed by the consolidated company. The sale was to be subject to prior mortgages aggregating more than two and a half millions of dollars. Any small number of those interested in the property might be unable or unwilling to buy property of such value and so incumbered. Why then shall the appellees be denied the privilege of uniting in a legal manner to protect their property by buying at an honest and fair sale? Their agreement was neither hurried nor secret. Its execution extended over more than one year. The first names were put to it on the 23d November, 1874, and the last on the 29th December, 1875. The appellant had ample knowledge of the sale and an opportunity of bidding thereat. He laid by for nearly

three and a half years; without objection permits the new company to be organized, and then files this bill. We fully concur in the conclusion of the learned judge that the whole evidence is insufficient to establish a fraud on the part of the appellees or create a trust in them for the benefit of the appellant. We deem many of the authorities cited by counsel for appellant inapplicable to the facts as we understand them. We will therefore not review them, nor answer the specifications of error *seriatim.* We discover no error in dismissing the bill.

Decree affirmed and appeal dismissed at the costs of the appellant.

NORTHERN PACIFIC RAILWAY CO. *v.* BOYD.

228 U.S. 482. 1912.

Boyd was entitled to a judgment for $71,278 against the Cœur D'Alene Railway and Navigation Company. The litigation in this matter was begun in 1887, and was not concluded until 1905. The Northern Pacific Rail*road* Company was indebted to the Cœur D'Alene Railway and Navigation Company, owing to an improper diversion of its assets, to an amount greater than the amount of this judgment. The Railroad Company's property passed in 1896 to the Northern Pacific Rail*way* Company. The question was whether the Railway Company could be charged with the obligation of the Railroad Company to the Cœur D'Alene Company, and hence to Boyd.

The circumstances attending the acquisition of the property of the Railroad Company by the Railway Company were as follows: —

On August 15, 1893, Winston and others filed in the United States Court for the Eastern District of Wisconsin a creditors' bill against the Northern Pacific Railroad alleging that it was insolvent, its mortgage bonds amounting to about $140,000,000 and its floating debts to $11,000,000, and praying for the appointment of a receiver to preserve the property as an entirety and to prevent it from being dismembered by separate sales under attachments and other liens. The company owned or controlled 54 subsidiary companies, and main and branch lines 4700 miles in length. It also owned or was entitled to receive about 40,000,000 acres under land grants. There were six mortgages — some on one part of the property, some on another and a general mortgage on the entire railroad lines. It also owned a large body of land which was not encumbered by liens. Interest had been paid on some of the bonds, but there had been a default in the interest on those secured by the junior mortgages.

Shortly after the filing of the creditors' bill a suit was brought in the same court by the trustees to foreclose these latter mortgages.

The cases were consolidated and the receivership continued under the consolidated causes. The Railroad demurred. As the road ran through several States, there were many questions of conflicting jurisdiction which were not settled until January 31, 1896, so that except for administrative orders, no steps were taken in the litigation proper.

The representatives of the stockholders intended to resist the foreclosure, and while recognizing the superior claim of the bonds, advised that "if properly protected, stockholders can secure equitable terms in any reorganization." There were also representatives of the bondholders, and ultimately the two interests agreed upon a plan, the terms of which were stated by the Reorganization Committee which, March 16, 1896, issued a circular to "holders of bonds and stocks issued or guaranteed by the Northern Pacific Railroad." This circular outlined a plan under which all of the stocks and bonds of the Railroad were to be transferred to a new company (the present Northern Pacific Railway Company) which was to purchase the property of the Railroad, issue new bonds, part of which were to be sold to raise money with which to discharge Receivers' Certificates, purchase needed equipment and make necessary betterments. The balance was to be issued in exchange for the bonds of the old company.

The plan also contemplated the issuance of preferred and common stock, part to be used in paying debts of the subsidiary companies, for which the Northern Pacific Railroad was liable, part for the expenses of the reorganization, and the balance to be issued in exchange for the outstanding stock of the Northern Pacific Railroad. Under the proposed plan the holder of $100 of preferred stock in the old company, upon paying $10 per share was to receive $50 of preferred and $50 of common stock in the new company. For each $100 of common stock the holder was to receive one share of common in the new corporation upon paying $15 per share. The aggregate of these cash payments on stock was about $11,000,000.

The records showing the cost of the original construction were not accessible, and in some particulars, the costs of the main and subsidiary lines appear to have been combined. But there is testimony tending to show that the cost of the railroad property, subject to the mortgage, was about $241,000,000. What was the value of the 40,000,000 acres of land is not stated. For several years prior to the receivership the road's net earnings had varied between $10,000,000 and $4,449,000. Its fixed charges amounted to $11,000,000 — showing an annual deficit of about $5,000,000. The bonds, unpaid interest and Receivers' Certificates aggregated at date of sale $157,000,000. The unsecured debts proved before the master amounted to about $15,200,000. The reorganization contemplated an issue of new bonds for $190,000,000 at lower rates of interest, $75,000,000 of

preferred stock, $80,000,000 of common stock — a total in bonds and stock of $345,000,000.

The reorganization agreement contained a statement that the property intended to be purchased was mutually agreed to be of the value of $345,000,000, payable in the stocks and bonds as above described.

The plan of reorganization was accepted, and on April 27, 1896, the decree of foreclosure was entered and the property ordered to be sold, on a date later fixed for July 25, 1896.

On July 22, 1896, Paton and others, holding contingent and unsecured claims for $5,500,000 against the Northern Pacific Railroad, filed a Bill, in the same court that had jurisdiction of the Creditors' Bill and Foreclosure suit, charging that the sale was the result of a conspiracy between bondholders and stockholders to exclude general creditors, and to award to stockholders in the old company rights in the new which were valuable and could not be legally reserved for the stockholders until first offered to and declined by the general creditors. It prayed that the decree of foreclosure should be opened; that the court would formulate a just and fair plan for distribution, and that the sale be enjoined. This was later modified so as to permit the sale to proceed, but asking an injunction to prevent the distribution of the proceeds and securities. The court held that the company was insolvent; that the assets were insufficient to pay the mortgage debts; that practical operation had demonstrated that the net earnings would not pay the fixed charges; that there was no equity in the property out of which unsecured creditors could be paid and no reason existed why the stockholders could not go into a reorganization plan whereby they would become stockholders in the new company, if it should become the purchaser. The prayer for injunction was denied. No appeal was taken.

On July 25 the railroad property was sold at public outcry to the newly organized Railway Company at a price representing $61,500,000, or $86,000,000 less than the secured debts. On July 27 the sale was reported to the court, and, all parties consenting, was three days later confirmed. The Railway Company entered into possession, and the first year its earnings were $489,000 above fixed charges, which had been lessened under the reorganization. The second year it declared a dividend of $3,000,000 and carried $3,000,000 to surplus. Since that time the earnings have been continually large, the business profitable and the value of the securities correspondingly great; but for a year after the sale, stock on which $10 and $15 had been paid in cash sold at prices varying from $18 to $51 for preferred and $13 and $18 for common.

In addition to the property covered by the mortgage, the Northern Pacific Railroad owned large quantities of land which were not encumbered, and in May, 1893, the Farmers' Loan and Trust Company

filed its Supplemental Bill describing this unmortgaged property and alleging that various intervening creditors had obtained judgments against the Railroad Company, some of which had been assigned to the trust company. It prayed that these lands of the Railroad should be sold and the proceeds applied to the satisfaction of the unsecured claims. On the same day that this Supplemental Bill was filed, the Railroad Company and other parties to the consolidated causes answered, the court adjudged that the complainant was entitled to the decree asked for, and appointed a Receiver of the property.

It was not, however, until April 27, 1899, that the sale was ordered. The property was thereupon sold to the Northern Pacific Railway for $1,623,000. The parties stipulated that the sale should be confirmed and on the same day in September, 1899, this was done.

MR. JUSTICE LAMAR. Boyd claimed that the foreclosure sale was void because made in pursuance of an illegal plan of reorganization, between bondholders and stockholders of the Railroad, in which, though no provision was made for the payment of unsecured creditors, the stockholders retained their interest by receiving an equal number of shares in the new Railway. There was no question as to parties and no demurrer to the bill. The Railway answered and on the trial of the merits offered evidence tending to support its contention that the decree was regular in form, free from fraud and that the property brought a fair price at public outcry. . . .

The original and supplemental decrees were free from any moral or actual fraud and were, in form and nature, sufficient to have passed a title good against him, unless the contract of reorganization, reserving a stock interest in the new company for the old shareholders, left the property still subject to the claims of non-assenting creditors of the Northern Pacific Rail*road*.

Corporations, insolvent or financially embarrassed, often find it necessary to scale their debts and readjust stock issues with an agreement to conduct the same business with the same property under a reorganization. This may be done in pursuance of a private contract between bondholders and stockholders. And though the corporate property is thereby transferred to a new company, having the same shareholders, the transaction would be binding between the parties. But, of course, such a transfer by stockholders from themselves to themselves cannot defeat the claim of a non-assenting creditor. As against him the sale is void in equity, regardless of the motive with which it was made. For if such contract reorganization was consummated in good faith and in ignorance of the existence of the creditor, yet when he appeared and established his debt the subordinate interest of the old stockholders would still be subject to his claim in the hands of the reorganized company. Cf. *San Francisco & N.P. R.R.* v. *Bee*, 48 California, 398; *Grenell* v. *Detroit Gas Co.*, 112 Michi-

gan, 70. There is no difference in principle if the contract of reorganization, instead of being effectuated by private sale, is consummated by a master's deed under a consent decree.

It is argued that this is true only when there is fraud in the decree, — the appellants insisting that in all other cases a judicial sale operates to pass a title which cuts off all claims of unsecured creditors against the property. They rely on *Wenger* v. *Chicago, &c., R.R.*, 114 Fed. Rep. 34; *Farmers' Loan & Trust Co.* v. *Louisville, &c., Ry. Co.*, 103 Fed. Rep. 110; *Pennsylvania Transportation Co.'s Appeal*, 101 Pa. St. 576; *Kurtz* v. *R.R.*, 187 Pa. St. 59; *Paton* v. *N.P. R.R.*, 85 Fed. Rep. 838; *Shoemaker* v. *Katz*, 74 Wisconsin, 374; *Bame* v. *Drew*, 4 Denio, 287; *Ferguson* v. *Ann Arbor R.R.*, 17 App. Div. 336; *McArdell* v. *Olcott*, 104 App. Div. 263; *S.C.*, 189 N.Y. 368, 384; *Candee* v. *Lord*, 2 N.Y. 269. Some of these cases hold directly, and others inferentially, that, in the absence of fraud, as here, a judicial sale is binding upon non-assenting creditors even though the decree was entered and the sale was made in pursuance of a contract, to which the stockholders were parties, and by which they were to retain a stock interest in the purchasing company. This makes the creditor's legal right against the shareholders' interest depend upon the motive with which they act and the method by which they carry out the scheme. If they do so by means of a private contract, though in ignorance of the existence of the creditor, the property remains liable for his debts. If they do so by means of a judicial sale under a consent decree and in like ignorance or disregard of his existence, the result is said to be different, although the shareholders should reserve exactly the same interest and deprive the creditor of exactly the same right.

Such and similar possibilities at one time caused doubts to be expressed as to whether a court could permit a foreclosure sale which left any interest to the stockholders. But it is now settled that such reorganizations are not necessarily illegal, and, as proceedings to subject the property must usually be in a court where those who ask equity must do equity, such reorganizations may even have an effect more extensive than those made without judicial sale, and bind creditors who do not accept fair terms offered. The enormous value of corporate property often makes it impossible for one, or a score, or a hundred bondholders to purchase, and equally so for stockholders to protect their interests. A combination is necessary to secure a bidder and to prevent a sacrifice. Coöperation being essential, there is no reason why the stockholders should not unite with the bondholders to buy in the property.

That was done in the present case. And while the agreement contained no provision as to the payment of unsecured creditors, yet the Railway Company purchased unsecured claims aggregating $14,000,000. Whether they were acquired because of their value, to avoid

litigation, or in recognition of the fact that such claims were superior to the rights of stockholders, does not appear, nor is it material. For, if purposely or unintentionally a single creditor was not paid, or provided for in the reorganization, he could assert his superior rights against the subordinate interests of the old stockholders in the property transferred to the new company. They were in the position of insolvent debtors who could not reserve an interest as against creditors. Their original contribution to the capital stock was subject to the payment of debts. The property was a trust fund charged primarily with the payment of corporate liabilities. Any device, whether by private contract or judicial sale under consent decree, whereby stockholders were preferred before the creditor, was invalid. Being bound for the debts, the purchase of their property, by their new company, for their benefit, put the stockholders in the position of a mortgagor buying at his own sale. If they did so in good faith and in ignorance of Boyd's claim, they were none the less bound to recognize his superior right in the property, when years later his contingent claim was liquidated and established. That such a sale would be void, even in the absence of fraud in the decree, appears from the reasoning in *Louisville Trust Co.* v. *Louisville Ry.*, 174 U.S. 674, 683, 684, where "assuming that foreclosure proceedings may be carried on to some extent at least in the interests and for the benefit of both mortgagee and mortgagor (that is, bondholder and stockholder)" the court said that "no such proceedings can be rightfully carried to consummation which recognize and preserve any interest in the stockholders without also recognizing and preserving the interests, not merely of the mortgagee, but of every creditor of the corporation. . . . Any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation."

The Railway seeks to distinguish that case from this, insisting that even if the stockholders' participation in the reorganization would have invalidated the proceeding, such result does not follow here because the court having charge of the foreclosure passed on this very question before the sale in 1896 and dismissed the Bill of Paton, an unsecured creditor, when he made exactly the same attack upon the reorganization as that by Boyd in this bill. That court then held that as the property was insufficient to pay the mortgage debts of $157,000,000, there was nothing which could come to the unsecured creditors, and they, therefore, had no ground to complain if the bondholders were willing to give new shares to the old stockholders. No appeal was taken from that decision — possibly because the Paton claim was purchased by the Railway. But inasmuch as Boyd was not a party to the record that decree was not binding upon him as *res adjudicata*, and the opinion not being controlling author-

ity, cannot be followed in view of the principles declared in *Chicago, R.I. & P. R.R.* v. *Howard,* 7 Wall. 392; *Louisville Trust Co.* v. *Louisville R.R.,* 174 U.S. 674.

In saying that there was nothing for unsecured creditors the argument assumes the very fact which the law contemplated was to be tested by adversary proceeding in which it would have been to the interest of the stockholders to interpose every valid defense. If, after a trial, a sale was ordered, they were still interested in making the property bring its value, so as to leave a surplus for themselves as ultimate owners. Even after sale they could have opposed its confirmation if the bids had been chilled, or other reason existed to prevent its approval. In the present case all these tests and safeguards were withdrawn. The stockholders, who, in lawfully protecting themselves, would necessarily have protected unsecured creditors, abandoned the defense that the foreclosure suit had been prematurely brought. The law, of course, did not require them to make or insist upon that defense if it was not meritorious, nor does it condemn the decree solely because it was entered by consent. But the shareholders were not merely quiescent. They, though in effect defendants, became parties to a contract with the creditors, who were in effect complainants, by which, in consideration of stock in the new company, they transferred their shares in the Railroad to the Railway. The latter then owning the bonds of the complainant and controlling the stock in the defendant, became the representative of both parties in interest. In such a situation there was nothing to litigate, and so the demurrer to the bill was withdrawn. An answer was immediately filed admitting all the allegations of the bill. On the same day, "no one opposing," a decree of foreclosure and sale was entered. Two months later the property was sold to the agreed purchaser at the upset price named in the decree. In a few days and by consent that sale was confirmed. As between the parties and the public generally, the sale was valid. As against creditors, it was a mere form. Though the Northern Pacific Railroad was divested of the legal title, the old stockholders were still owners of the same railroad, encumbered by the same debts. The circumlocution did not better their title against Boyd as a non-assenting creditor. They had changed the name but not the relation. The property in the hands of the former owners, under a new charter, was as much subject to any existing liability as that of a defendant who buys his own property at a tax sale.

The invalidity of the sale flowed from the character of the reorganization agreement regardless of the value of the property, for in cases like this, the question must be decided according to a fixed principle, not leaving the rights of the creditors to depend upon the balancing of evidence as to whether on the day of sale the property was insufficient to pay prior encumbrances. The facts in the present

case illustrate the necessity of adhering to the rule. The railroad cost $241,000,000. The lien debts were $157,000,000. The road sold for $61,000,000 and the purchaser at once issued $190,000,000 of bonds and $155,000,000 of stock on property which, a month before, had been bought for $61,000,000.

It is insisted, however, that not only the bid at public outcry, but the specific finding in the Paton case, established that the property was worth less than the encumbrances of $157,000,000, and hence that Boyd is no worse off than if the sale had been made without the reorganization agreement. In the last analysis, this means that he cannot complain if worthless stock in the new company was given for worthless stock in the old. Such contention, if true in fact, would come perilously near proving that the new shares had been issued without the payment of any part of the implied stock subscriptions except the $10 and $15 assessments. But there was an entirely different estimate of the value of the road when the reorganization contract was made. For that agreement contained the distinct recital that the property to be purchased was agreed to be "of the full value of $345,000,000, payable in fully paid non-assessable stock and the prior lien and general lien bonds to be executed and delivered as hereinafter provided."

The fact that at the sale, where there was no competition, the property was bid in at $61,000,000 does not disprove the truth of that recital, and the shareholders cannot now be heard to claim that this material statement was untrue and that as a fact there was no equity out of which unsecured creditors could have been paid, although there was a value which authorized the issuance of $144,000,000 fully paid stock. If the value of the road justified the issuance of stock in exchange for old shares, the creditors were entitled to the benefit of that value, whether it was present or prospective, for dividends or only for purposes of control. In either event it was a right of property out of which the creditors were entitled to be paid before the stockholders could retain it for any purpose whatever.

MR. JUSTICE LURTON, dissenting. (Mr. Chief Justice WHITE, Mr. Justice HOLMES, and Mr. Justice VAN DEVANTER concurred in the dissent.)

I find myself unable to agree with the opinion of the court. The consequences which may result from the decision to the numerous reorganizations of railroad companies which occurred about the time of this reorganization or since, are, to my mind, alarming. Arrangements and agreements in advance of judicial sales between creditors interested for the common benefit are the usual incidents of foreclosures, and if fairly and openly entered into and approved by the court are not subject to criticism.

Nor do I agree that every plan of reorganization which in any way includes stockholders of the reorganized company is for that reason

alone to be regarded as an illegal withholding from creditors of corporate property which should go to the payment of corporate debts. That corporate property must be applied to corporate debts before shareholders can participate, is plain. But I think every case should stand upon its own facts, and the remedy be shaped to do justice and equity in the particular case, and not tried out by any hard and fast rule such as indicated when this court says that the invalidity of a judicial sale must turn upon the character of the reorganization agreement and is not affected by actual consequences to creditors.

Here is a single creditor who comes forward many years after a judicial sale under a general creditors' bill and a mortgage foreclosure bill which had been pending several years, and asserts the right to ignore the judicial sale and the title resulting and asks to have the property of the old company subjected to his non-lien claim, not because of any actual fraud in the sale, nor because he can show that he has in any way suffered a loss by reason of the plan of reorganization under which the sale was conducted, but solely and simply because the shareholders of the debtor company are said to have participated in some way in the benefits of the sale. I think this goes too far and that there is no just foundation for upsetting a judicial sale upon the complaint of an unsecured creditor of the debtor company in the absence of proof of fraud in the decree. The cases supporting this view which I venture to say should control this case are cited in the opinion of the court. It is not a case of the transfer by stockholders of one company to themselves as stockholders of another. The railroad company was hopelessly insolvent. Its annual deficit was about five million dollars. Its general creditors, represented by the general creditors' bill, and its mortgage creditors, represented in the mortgage foreclosure proceeding, were endeavoring to prevent a disintegration and to bring the property to sale. The stockholders, represented by the company, were resisting. The receivership had already lasted for several years and the situation was growing steadily worse. The lien creditors, to save themselves, devised a plan for the sale and purchase of the property by a new company which should assume their claims, so far as possible, and put the new company in shape to meet its obligations. A large sum of actual money was necessary, and also the consent of the stockholders, to bring about a speedy sale. This money might be in part procured by the sale of the bonds of the new company; but if fixed charges were to be reduced, and the deficit of the old company turned into a surplus, the bonded debt and interest must be reduced. Therefore it was that most of this necessary money must come from the sale of stock. That was not a hopeful outlook. The value of this new stock was obviously speculative. The very basis of the plan to receive any large sum upon stock sales was believed to depend upon making a market among the stockholders of the old company. This was the

motive that led to the proposal that they should exchange their shares for those in the new company, paying the price stated. This actually produced about eleven of the twenty-five million dollars deemed essential to any arrangement which would save to the bondholders any large part of their debt. The price fixed turned out to be little below what the stock actually sold for on the open market for the year following the operation of the property by the purchasers. The subscription price to the shareholders, as the situation then appeared, was deemed fair, full and just by the very court which had approved the plan and decreed the sale, as is shown by the opinion of Judge JENKINS in the *Paton Case*, 85 Fed. Rep. 838.

It is true that Boyd was not a party to that suit. But it was a bill filed after the decree and before the sale, attacking the reorganization plan upon the precise grounds here advanced, and is highly persuasive as to the good faith of the plan and the fairness of the subscription price.

The upset price of sixty-one million dollars was fixed by the court, — probably as large as could be expected at the sale. As observed by this court in *Louisville Trust Co.* v. *Louisville, &c., Ry.*, 174 U.S. 674, 683, "railroad mortgages, or trust deeds, are ordinarily so large in amount that on foreclosure thereof only the mortgagees, or their representatives, can be considered as probable purchasers." Hence it was that the upset price must be fixed at such a sum as was reasonably within the range of any bidding which the property might be started at by the only probable bidders. The case last cited goes to the very verge of the law, but in that case the denunciation of such a plan of reorganization goes no farther than to condemn any arrangement by which the subordinate rights of stockholders are saved at the expense of creditors. That was not done here. The sale price was about eighty million dollars less than the lien claims entitled to be paid before creditors of the class to which Boyd belongs. Many of his class were actual parties to the consolidated cause in which the reorganization plan was approved and the sale decreed. They might have sought a larger upset price, but did not. They might have objected to the plan upon the grounds now brought forward, but they did not. They consented to the decree. They were doubtless hopeless of any sale price which could by any possibility save them, and therefore they stood aside.

NOTE. — The discussion of the question whether the complainant was barred by laches has been omitted. It was held that he was not barred.

There was a brief filed by an *amicus curiæ* insisting that the complainant's remedy was against stockholders of the Railroad Company, and not against the Railway Company or its property, but this brief was not discussed in the opinions.

Condenser Co. v. *Electric Co.*, 87 Kan. 843. Property of the corporation had been sold at a receiver's sale, and transferred to a new corporation pursuant to a plan of reorganization in which the stockholders had participated. An unsecured creditor of the old corporation was allowed to enforce his claim against the new corporation.

APPENDIX

OF

CORPORATE FORMS

CERTIFICATE OF INCORPORATION

OF

UNITED STATES STEEL CORPORATION.

We, the undersigned, in order to form a corporation for the purposes hereinafter stated, under and pursuant to the provisions of the Act of the Legislature of the State of New Jersey, entitled "An Act concerning corporations (Revision of 1896)," and the acts amendatory thereof and supplemental thereto, do hereby certify as follows:

I. The name of the corporation is United States Steel Corporation.

II. The location of its principal office in the State of New Jersey is at No. 51 Newark Street, in the City of Hoboken, County of Hudson. The name of the agent therein and in charge thereof, upon whom process against the corporation may be served is Hudson Trust Company. Said office is to be the registered office of said corporation.

III. The objects for which the corporation is formed are: —

To manufacture iron, steel, manganese, coke, copper, lumber and other materials, and all or any articles consisting, or partly consisting, of iron, steel, copper, wood or other materials, and all or any products thereof.

To acquire, own, lease, occupy, use or develop any lands containing coal or iron, manganese, stone, or other ores, or oil, and any wood lands, or other lands for any purpose of the Company.

To mine, or otherwise to extract or remove, coal, ores, stone and other minerals and timber from any lands owned, acquired, leased or occupied by the Company, or from any other lands.

To buy and sell, or otherwise to deal or to traffic in, iron, steel, manganese, copper, stone, ores, coal, coke, wood, lumber and other materials, and any of the products thereof, and any articles consisting, or partly consisting thereof.

To construct bridges, buildings, machinery, ships, boats, engines, cars and other equipment, railroads, docks, slips, elevators, water works, gas works and electric works, viaducts, aqueducts, canals and other water-ways, and any other means of transportation, and to sell the same, or otherwise to dispose thereof, or to maintain and operate the same, except that the Company shall not maintain or operate any railroad or canal in the State of New Jersey.

To apply for, obtain, register, purchase, lease, or otherwise to

acquire, and to hold, use, own, operate and introduce, and to sell, assign, or otherwise to dispose of, any trade-marks, trade names, patents, inventions, improvements and processes used in connection with, or secured under letters patent of the United States, or elsewhere, or otherwise; and to use, exercise, develop, grant licenses in respect of, or otherwise to turn to account any such trade-marks, patents, licenses, processes, and the like, or any such property or rights.

To engage in any other manufacturing, mining, construction or transportation business of any kind or character whatsoever, and to that end to acquire, hold, own and dispose of any and all property, assets, stocks, bonds and rights of any and every kind; but not to engage in any business hereunder which shall require the exercise of the right of eminent domain within the State of New Jersey.

To acquire by purchase, subscription or otherwise, and to hold or to dispose of, stocks, bonds or any other obligations of any corporation formed for, or then or theretofore engaged in or pursuing any one or more of the kinds of business, purposes, objects or operations above indicated, or owning, or holding any property of any kind herein mentioned; or of any corporation owning or holding the stocks or the obligations of any such corporation.

To hold for investment, or otherwise to use, sell, or dispose of, any stock, bonds or other obligations of any such other corporation; to aid in any manner any corporation whose stock, bonds or other obligations are held or are in any manner guaranteed by the Company, and to do any other acts or things for the preservation, protection, improvement or enhancement of the value of any such stock, bonds or other obligations, or to do any acts or things designed for any such purpose; and, while owner of any such stock, bonds or other obligations, to exercise all the rights, powers and privileges of ownership thereof, and to exercise any and all voting power thereon.

The business or purpose of the Company is from time to time to do any one or more of the acts and things herein set forth; and it may conduct its business in other States and in the Territories and in foreign countries, and may have one office or more than one office, and keep the books of the Company outside of the State of New Jersey, except as otherwise may be provided by law; and may hold, purchase, mortgage and convey real and personal property either in or out of the State of New Jersey.

Without in any particular limiting any of the objects and powers of the corporation, it is hereby expressly declared and provided that the corporation shall have power to issue bonds and other obligations, in payment for property purchased or acquired by it, or for any other object in or about its business; to mortgage or pledge any stocks, bonds or other obligations, or any property which may be acquired by it, to secure any bonds or other obligations by it issued or incurred; to guarantee any dividends or bonds or contracts or other obligations; to make and perform contracts of any kind and description; and in carrying on its business, or for the purpose of attaining or furthering any of the objects, to do any and all other acts and things; and to exercise any and all other powers which a copartnership or natural person could do and exercise, and which now or hereafter may be authorized by law.

IV. The total authorized capital stock of the corporation is three thousand dollars, divided into thirty shares of the par value of one hundred dollars each. Of such total authorized capital stock, fifteen shares, amounting to fifteen hundred dollars, shall be preferred stock, and fifteen shares, amounting to fifteen hundred dollars, shall be common stock.

From time to time, the preferred stock and the common stock may be increased according to law, and may be issued in such amounts and proportions as shall be determined by the board of directors, and as may be permitted by law.

The holders of the preferred stock shall be entitled to receive when and as declared, from the surplus or net profits of the corporation, yearly dividends at the rate of seven per centum per annum, and no more, payable quarterly, on dates to be fixed by the by-laws. The dividends on the preferred stock shall be cumulative, and shall be payable before any dividend on the common stock shall be paid or set apart; so that, if in any year dividends amounting to seven per cent. shall not have been paid thereon, the deficiency shall be payable before any dividends shall be paid upon or set apart for the common stock.

Whenever all cumulative dividends on the preferred stock for all previous years shall have been declared and shall have become payable, and the accrued quarterly installments for the current year shall have been declared, and the company shall have paid such cumulative dividends for previous years and such accrued quarterly installments, or shall have set aside from its surplus or net profits a sum sufficient for the payment thereof, the Board of Directors may declare dividends on the common stock, payable then or thereafter, out of any remaining surplus or net profits.

In the event of any liquidation or dissolution or winding up (whether voluntary or involuntary) of the corporation, the holders of the preferred stock shall be entitled to be paid in full both the par amount of their shares, and the unpaid dividends accrued thereon before any amount shall be paid to the holders of the common stock; and after the payment to the holders of the preferred stock of its par value, and the unpaid accrued dividends thereon, the remaining assets and funds shall be divided and paid to the holders of the common stock according to their respective shares.

V. The names and post-office addresses of the incorporators, and the number of shares of stock for which severally and respectively we do hereby subscribe (the aggregate of our said subscriptions, being three thousand dollars, is the amount of capital stock with which the corporation will commence business), are as follows:

Name	Post Office Address	Number of Shares	
		Preferred Stock	*Common Stock*
Charles C. Cluff . .	51 Newark Street, Hoboken, New Jersey	5	5
William J. Curtis .	Ditto	5	5
Charles MacVeagh .	Ditto	5	5

VI. The duration of the corporation shall be perpetual.

VII. The number of directors of the Company shall be fixed from time to time by the by-laws; but the number if fixed at more than three, shall be some multiple of three. The directors shall be classified with respect to the time for which they shall severally hold office by dividing them into three classes, each consisting of one-third of the whole number of the Board of Directors. The directors of the first class shall be elected for a term of one year; the directors of the second class for a term of two years; and the directors of the third class for a term of three years; and at each annual election the successors to the class of directors whose terms shall expire in that year shall be elected to hold office for the term of three years, so that the term of office of one class of directors shall expire in each year.

The number of the directors may be increased as may be provided in the by-laws. In case of any increase of the number of the directors the additional directors shall be elected as may be provided in the by-laws, by the directors or by the stockholders at an annual or special meeting; and one-third of their number shall be elected for the then unexpired portion of the term of the directors of the first class, — one-third of their number for the unexpired portion of the term of the directors of the second class, and one-third of their number for the unexpired portion of the term of the directors of the third class, so that each class of directors shall be increased equally.

In case of any vacancy in any class of directors through death, resignation, disqualification or other cause, the remaining directors, by affirmative vote of a majority of the Board of Directors, may elect a successor to hold office for the unexpired portion of the term of the director whose place shall be vacant, and until the election of a successor.

The Board of Directors shall have power to hold their meetings outside of the State of New Jersey at such places as from time to time may be designated by the by-laws or by resolution of the Board. The by-laws may prescribe the number of directors necessary to constitute a quorum of the Board of Directors, which number may be less than a majority of the whole number of the directors.

Unless authorized by votes given in person or by proxy by stockholders holding at least two-thirds of the capital stock of the corporation, which is represented and voted upon in person or by proxy at a meeting specially called for that purpose or at an annual meeting, the Board of Directors shall not mortgage or pledge any of its real property, or any shares of the capital stock of any other corporation; but this prohibition shall not be construed to apply to the execution of any purchase-money mortgage or any other purchase-money lien.

Any officer elected or appointed by the Board of Directors may be removed at any time by the affirmative vote of a majority of the whole Board of Directors. Any other officer or employe of the Company may be removed at any time by vote of the Board of Directors, or by any committee or superior officer upon whom such power of removal may be conferred by the by-laws or by vote of the Board of Directors.

The Board of Directors, by the affirmative vote of a majority of the whole board, may appoint from the directors an executive committee,

of which a majority shall constitute a quorum; and to such extent as shall be provided in the by-laws, such committee shall have and may exercise all or any of the powers of the Board of Directors, including power to cause the seal of the corporation to be affixed to all papers that may require it.

The Board of Directors, by the affirmative vote of a majority of the whole board, may appoint any other Standing Committee, and such Standing Committees shall have and may exercise such powers as shall be conferred or authorized by the by-laws.

The Board of Directors may appoint not only other officers of the Company, but also one or more vice-presidents, one or more assistant treasurers and one or more assistant secretaries; and, to the extent provided in the by-laws, the persons so appointed respectively shall have and may exercise all the powers of the president, of the treasurer and of the secretary, respectively.

The Board of Directors shall have power from time to time to fix and to determine and to vary the amount of the working capital of the Company; and to direct and determine the use and disposition of any surplus or net profits over and above the capital stock paid in; and in its discretion the Board of Directors may use and apply any such surplus or accumulated profits in purchasing or acquiring its bonds or other obligations, or shares of its own capital stock, to such extent and in such manner and upon such terms as the Board of Directors shall deem expedient; but shares of such capital stock so purchased or acquired may be resold, unless such shares shall have been retired for the purpose of decreasing the Company's capital stock as provided by law.

The Board of Directors from time to time shall determine whether and to what extent, and at what times and places, and under what conditions and regulations, the accounts and books of the corporation, or any of them, shall be open to the inspection of the Stockholders, and no Stockholder shall have any right to inspect any account or book or document of the corporation, except as conferred by Statute or authorized by the Board of Directors, or by a resolution of the Stockholders.

Subject always to by-laws made by the Stockholders, the Board of Directors may make by-laws, and, from time to time, may alter, amend or repeal any by-laws; but any by-laws made by the Board of Directors may be altered or repealed by the Stockholders, at any annual meeting, or at any special meeting, provided notice of such proposed alteration or repeal be included in the notice of the meeting.

IN WITNESS WHEREOF, we have hereunto set our hands and seals the 23rd day of February, 1901.

CHARLES C. CLUFF [L.S.]
WILLIAM J. CURTIS [L.S.]
CHARLES MACVEAGH [L.S.]

Signed, sealed and delivered
in the presence of
FRANCIS LYNDE STETSON.
VICTOR MORAWETZ.

STATE OF NEW JERSEY, } ss:
COUNTY OF HUDSON. }

Be it remembered that on this 23rd day of February, 1901, before the undersigned, personally appeared Charles C. Cluff, William J. Curtis and Charles MacVeagh, who, I am satisfied, are the persons named in and who executed the foregoing certificate; and I having first made known to them, and to each of them, the contents thereof, they did each acknowledge that they signed, sealed and delivered the same as their voluntary act and deed.

GEO. HOLMES,
Master in Chancery of New Jersey.

(10¢ I. R. Stamp Can.)

ENDORSED: "RECEIVED in the Hudson Co., N.J., Clerk's Office Feby 25th A.D. 1901, and Recorded in Clerks Record, No. on Page

"MAURICE J. STACK,
Clerk."

"FILED FEB. 25, 1901.
"GEORGE WURTS,
"*Secretary of State.*"

BY-LAWS

OF

CONSOLIDATED STEEL COMPANY.

ARTICLE I.

STOCKHOLDERS.

1. Annual Meeting. A meeting of the stockholders shall be held annually at the principal office of the company in New Jersey at ten o'clock in the forenoon on the second Monday in June, for the purpose of electing directors, and for the transaction of any other business authorized or required to be transacted by the stockholders. In case such second Monday shall be a legal holiday, the meeting shall be held on the next succeeding day which is not a legal holiday.

Notice of the annual meeting shall be mailed at least ten days prior to the meeting to each stockholder at the address last furnished by him to the company, provided he shall have furnished such address.

2. Special Meeting. Special meetings of the stockholders shall be held at the principal office of the company in New Jersey.

The board of directors may at any time call a special meeting of the stockholders, and it shall call the same whenever the holders of not less than one quarter of the stock of the company outstanding shall in writing make application therefor to the president, stating the object or objects of such meeting.

Notice of such special meeting and of the object or objects thereof shall be mailed to each stockholder in like manner as notice of an annual meeting.

3. Quorum. The holders of one-third of all the shares of the capital stock of the company outstanding shall constitute a quorum at any meeting for all purposes, including the election of directors; but the holders of a majority of the stock represented at any meeting may, at the end of one hour from the time for which the meeting was called, adjourn the meeting from time to time without further notice, and at any such adjourned meeting at which a quorum shall attend all business may be transacted which might have been transacted at the meeting as originally called.

4. Organization. The president, or in his absence a vice-president, shall call meetings of stockholders to order, and act as chairman

thereof. In case neither the president nor any vice-president is present, any stockholder present may call the meeting to order, and the stockholders present may then elect a chairman of such meeting.

The secretary of the company shall act as secretary at all meetings of the stockholders. In his absence, the chairman may appoint any person to act as secretary.

5. **Voting.** At any annual or special meeting each stockholder shall have one vote for each share of stock standing in his name on the books of the company at the time of the closing of the transfer books for said meeting.

Every stockholder shall be entitled to vote in person, or by proxy appointed by an instrument in writing, signed by such stockholder or by his duly authorized agent, and delivered to such person or persons as the chairman of the meeting may direct. A stockholder shall be deemed to be present whether present in person or represented by proxy.

Voting for directors shall be by ballot, and upon the demand of any stockholder present the voting upon any question shall be by ballot.

6. **Inspectors.** Whenever the vote of the stockholders shall be taken by ballot, the chairman of the meeting shall appoint two persons to be inspectors. The inspectors shall be sworn to the faithful performance of their duties; they shall open and close the polls; they shall decide all questions as to the validity of proxies and the qualification of voters; and they shall, in writing, certify to the results.

ARTICLE II.

BOARD OF DIRECTORS.

1. **Number.** The board of directors shall consist of fifteen members.

2. **Term of Office.** At the first election of directors, five directors shall be elected to hold office until the first annual meeting thereafter; five to hold office until the second annual meeting thereafter, and five to hold office until the third annual meeting thereafter. At each annual meeting, the successors to the directors whose term shall expire in that year shall be elected to hold office for the term of three years, so that the term of office of five directors shall expire in each year. A majority of votes cast shall be necessary to elect.

Each director shall serve for the term for which he shall have been elected, and until his successor shall have been duly elected and qualified.

3. **Vacancies.** In case of any vacancy in any class of directors, through death, resignation, disqualification or other cause, the remaining directors, by affirmative vote of a majority of their number, whether

constituting a quorum or not, may elect a successor to hold office for the unexpired portion of the term of the director whose place shall be vacant, and until his successor shall have been duly elected and qualified.

4. **Meetings.** The board of directors may hold its meetings and have one or more offices and keep the books of the company, except the stock and transfer books, at such place or places in the State of New Jersey or outside of the State of New Jersey as it may from time to time determine.

Stated meetings shall be held on the first Wednesday of each month at 12 o'clock noon. If such day is a legal holiday, the meeting shall be held on the next succeeding day which is not a legal holiday. No notice shall be required for any stated meeting.

Special meetings may be called by the president or any three directors. Each director shall furnish to the secretary an address to which notices of special meetings may be sent. Notice of the time and place of each special meeting shall be sent to each director who has furnished such address, and such notice shall be sent, if by mail, at least two days, or, if by telegram, at least six hours, prior to the meeting.

A majority of the directors in office shall constitute a quorum. A majority of those present at the time and place of any stated or special meeting, although less than a quorum, may adjourn the meeting from time to time, without notice.

5. **Powers.** The board of directors shall have the management of the business of the company. The board may exercise all such powers of the company and do all such lawful acts and things as are not by statute, or by the certificate of the company, or by these by-laws directed or required to be exercised or done by the stockholders.

6. **Compensation.** Each director shall receive $10 for attendance at any meeting of the board.

7. **Executive Committee.** The directors shall elect from their number an executive committee, to consist of six members, and shall designate one of such six members to be the chairman of the committee. The members of the committee and the chairman thereof shall serve during the pleasure of the board.

During the intervals between the meetings of the board of directors the executive committee shall possess and may exercise all the powers of the board of directors in such manner as the executive committee shall deem best for the interests of the company in all cases in which specific directions shall not have been given by the board of directors. All action by the executive committee shall be reported to the board of directors at its meeting next succeeding such action, and shall be subject to revision or alteration by the board of directors; provided that no rights or acts of third parties shall be affected by any such revision or alteration.

The executive committee may hold its meetings at such times and places as it may determine.

In every case the affirmative vote of a majority of all the members of the committee shall be necessary to the adoption of any resolution.

The compensation of members of the executive committee shall be fixed by the board of directors.

ARTICLE III.

OFFICERS.

1. Election or Appointment. The board of directors shall elect from their number a president, and shall appoint a treasurer and a secretary. The board may also appoint one or more vice-presidents, one or more assistant treasurers, one or more assistant secretaries, and such other officers as it may deem advisable.

The same person may be treasurer and an assistant secretary, or secretary and an assistant treasurer, or an assistant treasurer and an assistant secretary.

2. Term of Office and Compensation. The officers so elected or appointed shall hold office during the pleasure of the board, and their compensation shall be fixed by the board.

3. Duties of Officers. The president shall preside at meetings of the stockholders and of the board of directors. He shall be the chief executive officer of the company and shall have general charge of the business of the company, subject to the executive committee and the board.

The treasurer shall give such bond for the faithful discharge of his duties as the board may require. He shall have custody of all the funds and securities of the company which may have come into his hands, and shall keep full and accurate accounts of all moneys received and paid by him on account of the company.

The secretary shall keep the minutes of all meetings of the stockholders and of the board, and of the executive committee; he shall attend to the giving and serving of all notices; and he shall have the custody of the seal of the company.

The president, treasurer, and secretary shall, in general, perform the duties incident to their offices, and any other duties designated by the board. All other officers shall perform such duties as may be designated by the board.

4. Execution of Instruments on behalf of the Company. All certificates for shares of the capital stock of the company, all bills of exchange, promissory notes and checks issued, drawn, or made by the company shall be signed by the president or a vice-president, and by the treasurer or an assistant treasurer. All other contracts or obligations of the company shall be executed by such officer or officers as the board may direct. The seal of the company shall be affixed to such

instruments as the board may direct, and, when so affixed, shall be attested by a secretary or an assistant secretary, if the board shall so direct.

ARTICLE IV.

CAPITAL STOCK. DIVIDENDS. SEAL.

1. Certificates of Shares. The certificates for shares of the capital stock shall be in such form, not inconsistent with the certificate of incorporation, as shall be approved by the board of directors.

No certificate shall be valid unless it is sealed with the corporate seal of the company, and signed by the president, or a vice-president, and the treasurer, or an assistant treasurer, and such other persons as the board may determine.

All certificates shall be consecutively numbered. The name of the person owning the shares represented thereby, with the number of such shares and the date of issue, shall be on the company's books.

2. Transfer of Shares. Shares of the capital stock of the company shall be transferred only on the books of the company by the holder thereof in person, or by his attorney, upon surrender and cancellation of certificates for a like number of shares, or (in case of lost or destroyed certificates) upon the receipt of a bond satisfactory to the board.

The board of directors shall have power to make all such rules and regulations as they may deem expedient concerning the issue, transfer, and registration of certificates for shares of the capital stock of the company; and to appoint a transfer agent and a registrar of transfers, and to require all stock certificates to bear the signature of such transfer agent and of such registrar of transfers.

The stock transfer books shall be closed for the meetings of stockholders and for the payment of dividends during such periods as may be fixed by the board, and during such periods no stock shall be transferable.

3. Dividends. The board of directors in its discretion may from time to time declare dividends upon the capital stock from the surplus or net profits of the company, subject to the provisions of the certificate of incorporation.

4. Working Capital. The board of directors may fix a sum which may be set aside or reserved, over and above the company's capital stock paid in, as a working capital for the company, and from time to time the board may increase, diminish, and vary the same in its absolute judgment and discretion.

5. Corporate Seal. The board of directors shall provide a suitable seal containing the name of the company, which shall be in the custody of the secretary.

ARTICLE V.

AMENDMENTS.

These by-laws may be altered or amended by the stockholders at any regular or special meeting, or by the directors at any regular or special meeting, provided not less than eight directors shall vote in favor of such alteration or amendment.

MINUTES OF FIRST MEETING OF INCORPORATORS

OF

CONSOLIDATED STEEL COMPANY.

The first meeting of the incorporators of Consolidated Steel Company was held at Number 10 Day Street, Hoboken, New Jersey, designated in the certificate of incorporation as the location of the principal and registered office of the company, on the sixth day of April, 1909, at ten o'clock in the forenoon, pursuant to a written waiver of notice signed by all the incorporators, fixing the time and place aforesaid.

The following incorporator was present in person:

NAME.	NUMBER OF SHARES.
John Adams,	10.

The following incorporators were represented by proxy:

NAME.	NAME OF PROXY.	NUMBER OF SHARES.
James Brown,	John Adams,	10.
Charles Clark,	John Adams,	10.

Mr. John Adams was elected chairman, and Mr. Hugh Knowles was appointed secretary of the meeting.

The chairman reported that the certificate of incorporation of the company was recorded in the office of the Clerk of Hudson County on the fifth day of April, 1909, and was filed on the same date in the office of the Secretary of State of New Jersey. The chairman presented a certified copy of said certificate of incorporation, which was ordered to be filed, and a copy thereof to be spread upon the records of the meeting.

The said certified copy was as follows:

[Here take in certified copy of certificate of incorporation.]

The secretary presented and read the waiver of notice of the meeting, which was ordered to be filed, and a copy thereof to be spread upon the records of the meeting.

The said waiver was as follows:

"WAIVER OF NOTICE OF FIRST MEETING OF INCORPORATORS

OF

CONSOLIDATED STEEL COMPANY.

We, the undersigned, being all of the incorporators of Consolidated

Steel Company, a New Jersey corporation, DO HEREBY WAIVE NOTICE of the time, place, and purpose of the first meeting of the incorporators of said company, and do fix the sixth day of April, 1909, at ten o'clock in the forenoon, as the time, and the office of the Security Trust Company, Number 10 Day Street, Hoboken, New Jersey, as the place of said meeting, and do hereby waive all the requirements of the statutes of New Jersey as to notice of such meeting, and the publication thereof, and we do consent to the transaction of such business as may come before said meeting.

Dated, April 6th, 1909.

JOHN ADAMS.
JAMES BROWN.
CHARLES CLARK."

The secretary presented a form of by-laws for the regulation of the affairs of the company which were read, article by article, and unanimously adopted.

The said by-laws were as follows:

[Here take in by-laws.]

Upon motion,

Resolved, that the meeting proceed to the election of directors.

Messrs. G. H. Ivins and K. L. Munro were appointed inspectors of election, and the oath was duly administered to them.

Messrs. Henry Chamberlain, Frank M. Converse, Richard T. Frances, Lawrence K. McIntyre, and Philip Talbot were nominated for directors to hold office until the next annual meeting of the company; Messrs. George Bathurst, Arthur K. Livingston, Samuel P. Stacy, Amasa Thompson, and William K. Waring were nominated for directors to hold office until the second annual meeting of the company; Messrs. Hiram A. Hilbreth, George Ivins, Isaac Jones, Herbert S. Pendreigh and Walter M. Stickney were nominated for directors to hold office until the third annual meeting of the company.

No other nominations having been made, the polls were declared open. All the stockholders having voted by ballot, the polls were declared closed, and the inspectors presented their certificate showing that the aforesaid gentlemen had been elected directors of the company for the aforesaid terms.

Upon motion,

Resolved, that the principal and registered office of the company in New Jersey be established and maintained at Number 10 Day Street, Hoboken, County of Hudson, and that the Security Trust Company be, and it hereby is, appointed the agent of this corporation in charge of such principal and registered office, upon whom process against this company may be served.

Upon motion duly made and seconded, and by the affirmative vote of all the stockholders, it was

Resolved, that the board of directors be and they hereby are authorized to issue shares of the capital stock of this company to the full amount authorized by the certificate of incorporation, in such amounts, and at such time or times, and for such consideration as the board may determine.

Upon motion duly made and seconded, and by the affirmative vote of all the stockholders, the following preambles and resolution were adopted:

Whereas, Mr. James Wakefield, of Pittsburg, Pennsylvania, has offered, in consideration of the issue to him or upon his order of preferred stock in this company to the amount of one hundred thousand dollars ($100,000) par value, and of common stock in this company to the amount of one hundred and fifty thousand dollars ($150,000) par value, to sell to this company the following described property, to wit:

[Here take in description of property]; and

Whereas, in the judgment of the stockholders such property is necessary for the business of this company, and is of the fair value of two hundred and fifty thousand dollars ($250,000);

Resolved, that the directors of this company be and they hereby are authorized, in their discretion, to purchase the aforesaid property for the aforesaid price, and to issue stock as aforesaid in payment thereof.

On motion, the meeting adjourned.

Hugh Knowles,
Secretary of the Meeting.

MINUTES OF FIRST MEETING OF BOARD OF DIRECTORS

OF

CONSOLIDATED STEEL COMPANY.

The first meeting of the board of directors of Consolidated Steel Company was held at Number 17 Wall Street, New York City, on the sixth day of April, 1909, at two o'clock in the afternoon, pursuant to a written waiver of notice signed by all the directors, fixing the time and place aforesaid.

The following directors were present: Messrs. Chamberlain, Converse, Talbot, Bathurst, Livingston, Stacy, Jones, and Pendreigh, being a quorum of the board.

On motion, Mr. Talbot was chosen temporary chairman, and Mr. Hugh Knowles was appointed secretary of the meeting.

The secretary presented and read the waiver of notice of the meeting, which was ordered to be filed, and a copy thereof to be spread upon the records of the meeting.

The said waiver was as follows:

[Here take in waiver of notice.]

The minutes of the first meeting of the incorporators of the company were read.

Upon motion, the following gentlemen were elected officers of the company, to hold office during the pleasure of the board.

President: Mr. George Bathurst.

Vice-Presidents: Mr. John Adams and Mr. Philip Livermore.

Treasurer: Mr. John G. Holmes.

Assistant Treasurer: Mr. Hugh Knowles.

Secretary: Mr. Hugh Knowles.

Assistant Secretary: Mr. John G. Holmes.

Upon motion, the following gentlemen were chosen to constitute the executive committee of the company: Messrs. Bathurst, Chamberlain, Converse, Livingston, Jones, and Pendreigh.

Upon motion, Mr. Converse was designated to be chairman of the executive committee.

Upon motion, Mr. Brandon Livermore was appointed counsel to the company.

The president thereupon took the chair.

The secretary thereupon took and subscribed the oath of office, and entered upon the discharge of his duties. The said oath was as follows:

"OATH OF SECRETARY

OF

CONSOLIDATED STEEL COMPANY.

STATE OF NEW YORK, }
COUNTY OF NEW YORK. } ss.:

Hugh Knowles, secretary of Consolidated Steel Company, a New Jersey corporation, being by me duly sworn, upon his oath deposes and says that he will faithfully discharge the duties of secretary of the aforesaid corporation to the best of his skill and ability.

HUGH KNOWLES.

Subscribed and sworn to before me,
this sixth day of April, 1909.

JOHN K. ANDREWS,
Notary Public (17),
New York County."

Upon motion,

Resolved, that the treasurer give a bond in the sum of fifty thousand dollars ($50,000).

The treasurer thereupon presented his bond, signed by himself as principal and by the Attorneys Surety Company as surety, and the same was approved, and ordered to be filed with the secretary.

Upon motion,

Resolved, that the seal presented at this meeting, an impression of which is directed to be made in the minute book, be and the same hereby is adopted as the seal of the company.

The impression of said seal follows:

[Seal.]

Upon motion,

Resolved, that the stock book and transfer book presented at this meeting be and the same hereby are adopted as the stock book and the transfer book of the company, and the secretary is hereby directed to send the same to the registered office of the company.

Upon motion,

Resolved, that the treasurer be, and he hereby is, authorized to open a bank account in behalf of the company with the Empire State National Bank.

Further Resolved, that, until otherwise ordered, checks, notes, and other obligations may be endorsed on behalf of the company for collection, by either the treasurer, or an assistant treasurer, and deposited to the credit of the company in the said bank.

Further Resolved, that, until otherwise ordered, the said bank be and it hereby is authorized to make payments from the funds of this company on deposit with it, according to the check of this company signed by its president, or a vice-president, and countersigned by the treasurer or an assistant treasurer.

Upon motion,

Resolved, that the forms of certificates for shares of the common and preferred stock of the company presented at this meeting be and they hereby are adopted, and that such forms be spread upon the records of the meeting.

The forms of stock certificates were as follows:

[Here take in forms of stock certificates.]

Upon motion,

Resolved, that the Security Trust Company, a New Jersey corporation, be and it hereby is designated as the transfer agent of this company, and the New Jersey Bonding Company, a New Jersey corporation, be and it hereby is designated as the registrar of transfers, and that all certificates for shares of the capital stock of the company shall be countersigned by such transfer agent and also by such registrar of transfers.

Upon motion,

Resolved, that this company establish and maintain an office in Room 10, Number 17 Wall Street, New York City, and that all meetings of the board of directors shall be held at such office until otherwise ordered.

Upon motion duly made and seconded, and on the affirmative vote of all present, the following preambles and resolutions were adopted:

Whereas, Mr. James Wakefield, of Pittsburg, Pennsylvania, has offered, in consideration of the issue to him or upon his order of preferred stock in this company to the amount of one hundred thousand dollars ($100,000) par value, and of common stock in this company to the amount of one hundred and fifty thousand dollars ($150,000) par value, to sell to this company the following described property, to wit:

[Here take in description of property]; and

Whereas, in the judgment of the directors such property is necessary for the business of this company, and is of the fair value of two hundred and fifty thousand dollars ($250,000);

Resolved, that it be adjudged and declared that said property is of the fair value of two hundred and fifty thousand dollars ($250,000), and that the same is necessary for the business of the company.

Further Resolved, that the form of agreement for the purchase of said property presented at this meeting by the counsel to the company, be, and the same hereby is, approved, and the president or a vice-president, and the secretary or the assistant secretary are hereby

authorized and directed to execute the same, in the name of, and on behalf of the company, and under its corporate seal.

Further Resolved, that upon the conveyance or transfer to this company of the said property by instruments of conveyance or transfer satisfactory to the counsel to the company, the officers of this company be and they hereby are authorized and directed to prepare, sign, and seal certificates of stock pursuant to the by-laws, and to issue certificates of the full paid preferred stock of this company to the aggregate amount of one hundred thousand dollars (100,000), and of the common stock of this company to the aggregate amount of one hundred and fifty thousand dollars ($150,000) to the said James Wakefield, or upon his order.

Upon motion, the meeting adjourned.

HUGH KNOWLES,
Secretary.

LISTING OF SECURITIES

OF

CONSOLIDATED STEEL COMPANY.

To the Committee on Stock List of the   Stock Exchange:

Consolidated Steel Company hereby makes application to have the following bonds and stock of said company placed on the regular list of the   Stock Exchange:

Ten million dollars ($10,000,000) first mortgage five per centum gold bonds, consisting of nine thousand (9000) bonds for one thousand dollars ($1000) each, numbered from M 1 to M 9000 both inclusive, and of two thousand (2000) bonds for five hundred dollars ($500) each, numbered from D 9001 to D 11000 both inclusive;

Ten million dollars ($10,000,000) seven per centum cumulative preferred stock;

Ten million dollars ($10,000,000) common stock.

Consolidated Steel Company was organized on April 6, 1909, under the laws of the State of New Jersey, and its certificate of incorporation was amended on April 26, 1909.

The company has acquired under the laws of the States of New Jersey, Pennsylvania, and New York, by direct conveyance, free of liens, the following property:

The plant, stock in trade, good will, and all other assets of the iron business formerly carried on in Pittsburg, Pennsylvania, by James Wakefield, doing business as James Wakefield and Company;

The plant, stock in trade, good will, and all other assets of the business formerly carried on in Lebanon, Pennsylvania, by the Lebanon Iron Company, a Pennsylvania corporation;

The plant located in Buffalo, New York, formerly owned by the Delaware Iron Company, a Pennsylvania corporation, and commonly known as the Buffalo Mill, together with all the stock in trade in said plant.

The company has also acquired the following securities:

Three million dollars ($3,000,000) six per centum first mortgage bonds of the Delaware Iron Company, part of a total of four million eight hundred thousand dollars ($4,800,000) of such bonds issued by said company and now outstanding;

Five thousand and thirty-three (5033) shares of the common stock of the Delaware Iron Company out of a total of ten thousand (10,000) shares of common stock issued by said company and now outstanding (no preferred stock having been issued by said company).

Consolidated Steel Company had on the 27th day of April, 1909, one

million eight hundred seventy-three thousand four hundred thirty-two dollars and forty-three cents ($1,873,432.43) in its treasury.

First Mortgage Five Per Centum Gold Bonds.

These bonds bear date April 27, 1909; mature January 1, 1929; bear interest from January 1, 1909, payable January 1 and July 1; are payable, principal and interest, at the office of Black and Company in the city of New York in gold coin of the United States of America of or equal to the present standard of weight and fineness without deduction for any tax or taxes which the company may be required to pay thereon and retain therefrom under any present or future law of the United States of America or of any state, county, or municipality thereof; and they or any of them are redeemable at the option of the company on six months' notice on January 1, 1919, or any interest day thereafter, at five per centum premium and accrued interest. The said bonds are of an issue limited to the principal amount of twenty million dollars ($20,000,000) at any one time outstanding. The bonds are in coupon form with the right of registration as to principal. The trustee of the mortgage is Interborough Trust Company of New York. The transfer agency for the registered bonds will be at the office of the company in New York City.

To secure said bonds the company has executed and delivered to Interborough Trust Company of New York its first mortgage dated April 27, 1909, covering the properties in Pittsburg, Lebanon, and Buffalo above mentioned, and the stock and bonds also above mentioned, and such other properties as are in said mortgage more particularly described.

Seven Per Centum Cumulative Preferred Stock.

The holders of such preferred stock are entitled to receive from the surplus or net profits arising from the business of the corporation a fixed yearly dividend of seven per centum, payable semi-annually on the 2d days of January and July in each year, before any dividend is set apart or paid on the common stock.

Should the surplus or net profits arising from the business of the corporation prior to any dividend day be insufficient to pay the dividend upon the preferred stock, such dividends are payable from the future profits, and no dividend is at any time to be paid upon the common stock until the full amount of seven per centum per annum up to that time upon all the preferred stock shall have been paid or set apart. The holders of preferred stock are entitled to no dividends beyond the seven per centum aforesaid.

The holders of preferred stock are entitled in case of the liquidation or dissolution of the company to be paid in full both the principal of their shares and accrued dividends before any amount is paid to the holders of the common stock.

The total amount of the preferred stock authorized is twenty million dollars ($20,000,000), ten million dollars ($10,000,000) of which has been issued.

COMMON STOCK.

The total amount of the common stock authorized is twenty million dollars ($20,000,000), of which ten million dollars ($10,000,000) has been issued.

The board of directors of Consolidated Steel Company is constituted as follows:

Messrs. Henry Chamberlain, Frank M. Converse, Richard T. Frances, Lawrence K. McIntyre, Philip Talbot, George Bathurst, Arthur K. Livingston, Samuel P. Stacy, Amasa Thompson, William K. Waring, Hiram A. Hilbreth, George Ivins, Isaac Jones, Herbert S. Pendreigh, and Walter M. Stickney.

The officers of Consolidated Steel Company are as follows:

President: Mr. George Bathurst.
Vice-Presidents: Mr. John Adams and Mr. Philip Livermore.
Treasurer: Mr. John G. Holmes.
Assistant Treasurer: Mr. Hugh Knowles.
Secretary: Mr. Hugh Knowles.
Assistant Secretary: Mr. John G. Holmes.

The principal office of Consolidated Steel Company is at No. 10 Day Street, in the city of Hoboken, County of Hudson, State of New Jersey; the company also maintains offices at No. 17 Wall Street, New York City, and at No. 3 Scranton Street, Lebanon, Pennsylvania.

Herewith are submitted:

1. Copy of the certificate of incorporation of Consolidated Steel Company.

2. Copy of the amended certificate of incorporation of Consolidated Steel Company.

3. Seven copies of the first mortgage of Consolidated Steel Company, including one copy certified by Interborough Trust Company of New York to be a true copy of the original.

4. Certificate of Interborough Trust Company of New York acknowledging the acceptance of the trust under said first mortgage, stating the securities held under the trust, and giving the numbers of the first mortgage bonds executed in accordance with the terms of the mortgage.

5. Copy of the by-laws of Consolidated Steel Company.

6. Opinion of counsel.

7. Balance sheet of Consolidated Steel Company, as of May 1, 1909, certified by Strong, Longmead, and Company.

8. Statement of earnings and expenses of the three businesses car-

ried on in the plants above mentioned for the year ending January 1, 1909, also certified by Strong, Longmead, and Company.

9. Sample copies of bonds, coupons, and stock certificates.

CONSOLIDATED STEEL COMPANY,
By GEORGE BATHURST,
President.

Accompanying the foregoing application was the following opinion of counsel:

To the Committee on Stock List of the Stock Exchange:

GENTLEMEN:

We have examined the certificate of incorporation of Consolidated Steel Company, a New Jersey corporation, and the amendments thereto, and the proceedings relating to the organization of that company and to the issue of its preferred and common stock.

We are of opinion that said company has been legally incorporated and organized under the laws of the State of New Jersey; that it has power to issue seven per centum cumulative preferred stock to the par amount of twenty million dollars ($20,000,000) and common stock to the par amount of twenty million dollars ($20,000,000); that preferred stock to the amount of ten million dollars ($10,000,000) and common stock to the amount of ten million dollars ($10,000,000) has been issued in due form, and that the action of the directors and stockholders of said company in respect of said stock, both preferred and common, was in conformity with the laws of the State of New Jersey.

We have also examined the first mortgage dated April 27, 1909, made by said company to Interborough Trust Company of New York as trustee to secure an issue of its five per centum first mortgage gold bonds, and we are of opinion that the action of the directors and stockholders of said company in respect to this mortgage was in conformity with law, that the said mortgage is a valid lien on the properties therein mentioned, and that the bonds issued under said mortgage are valid and binding obligations of said company.

Yours faithfully,

STOCKTON AND LIVERMORE.

SYNDICATE AGREEMENT.

Agreement, made this fifth day of April, one thousand nine hundred and nine, by and between Brown & Company and Jones & Company, of New York, and Smith & Company, of London, as Readjustment Managers (hereinafter called the "Readjustment Managers"), parties of the first part; Talbot & Company, of London, Watkins & Company and Weill & Company, of New York, as Syndicate Managers (hereinafter called the "Syndicate Managers"), parties of the second part; and the Syndicate Subscribers hereto (hereinafter called the "Subscribers"), parties of the third part, who together with the Syndicate Managers constitute the Syndicate, each subscriber being bound only ratably to the extent of his own subscription and not for any other subscriber or subscription.

Whereas, pursuant to a certain plan and agreement of readjustment, dated April 5, 1909, about to be issued, it is proposed to undertake a readjustment of the affairs of the New York & Buffalo Railroad Company on the basis of an issue of twenty million dollars ($20,000,000) Prior Lien 4½ per cent Gold Mortgage Bonds (which issue may for the purposes in said plan specified be increased as therein stated), and fifteen million dollars ($15,000,000) First Consolidated Mortgage 4 per cent Gold Bonds (which issue may be increased for the purposes in the said plan specified as therein stated), and of an issue of twenty-five million dollars ($25,000,000) in Four Per Cent Non-Cumulative Preferred Stock (which issue may for the purposes in said plan specified be increased as therein stated), and of thirty-three million three hundred and fifty thousand dollars ($33,350,000) in New Common Stock; it being understood that to the extent that the existing bonds shall not be exchanged for new securities under the offer in the plan, or not retired by payment on redemption or in dissolution proceedings, or otherwise, the new securities respectively apportioned to such bonds under the plan shall be reserved for the ultimate redemption thereof; and

Whereas, in order to provide the cash requirements of said plan as hereinafter set forth, the Readjustment Managers have undertaken to form a syndicate to which the parties of the third part desire to be admitted as subscribers, and it is proposed that to the extent and in the manner hereinafter provided the Syndicate shall provide such cash requirements of the said plan and purchase the new securities as hereinafter provided;

Now, this Agreement Witnesseth, that in consideration of the mutual promises herein contained, the parties hereto agree with each other and with the Readjustment Managers and the Syndicate Managers, the said Syndicate Subscribers agreeing each for himself and not for any other, as follows:

First. The parties of the second and third parts hereto hereby form a syndicate for the purpose of providing the cash requirements of the said Plan of Readjustment of the New York & Buffalo Railroad Company. The maximum amount or obligation of the syndicate shall not exceed the sum of twenty-five million dollars ($25,000,000), and such obligations shall be divided and apportioned as recited in this agreement. This agreement shall not take effect until the said maximum amount shall have been subscribed.

Second. The syndicate agrees to take and pay for and the Readjustment Managers will sell and deliver the following new securities when issued, or certificates therefor entitling the holders to the new securities when issued, viz.:

(1) $9,221,000.00 Prior Lien 4½ Per Cent Gold Mortgage Bonds.

$3,595,312.50 First Consolidated Mortgage 4 Per Cent Gold Bonds.

$2,400,000.00 New 4 Per Cent Preferred Stock (Trust Certificates) for the sum of twelve million nine hundred and sixty-seven thousand three hundred and sixty-seven dollars ($12,967,367), plus any interest accrued on said bonds when delivered.

(2) The Syndicate, if so requested by the Readjustment Managers, will further take and pay for such part of the $10,779,000 new Prior Lien 4½ Per Cent Gold Mortgage Bonds (or Certificates therefor entitling the holders to such new Bonds when issued), which under the Plan are to be offered to the holders of the present outstanding New York & Buffalo Railroad Company First Mortgage (Prior Lien) 6 Per Cent Bonds, as may not be taken by them within the time limit fixed by the Readjustment Managers, at the price of $985 per bond, plus any interest accrued on said bonds when delivered.

(3) The Syndicate further agrees with the Readjustment Managers to advance to them or on their order cash not exceeding in the aggregate the sum of ten million dollars ($10,000,000) if the Readjustment Managers shall in their discretion deem that such cash advances will tend to promote the consummation of the Plan of Readjustment, as follows, viz.:

(*a*) To advance moneys on the security of the existing bonds or coupons or stock trust certificates of the New York & Buffalo Railroad or certificates issued by the Readjustment Managers entitling their holders to new securities when issued, or upon other securities satisfactory to the Syndicate Managers.

(*b*) To advance cash to purchase any properties whose securities are owned by the New York & Buffalo Railroad Company, or any part thereof, on any sale of said properties in dissolution proceedings or otherwise.

The Syndicate shall make such advances from time to time upon twenty days' written notice from the Readjustment Managers to the Syndicate Managers. Such advances shall be repaid with interest at the rate of 6 per cent per annum out of the proceeds of the new securities deliverable hereunder. The Readjustment Managers, however,

shall in no event be personally liable in respect of any obligation, advance, purchase or loan hereunder.

Third. Each subscriber signing this agreement shall set opposite his name and address the amount of his subscription to the Syndicate, and shall from time to time and at any time on call of the Syndicate Managers make cash payments on account of his subscription hereunder. Not over five million dollars ($5,000,000) (twenty per cent) in money in the aggregate shall be called from the Syndicate subscribers in any one month. Payments from the subscribers shall be due ten days after the sending of written notice from the Syndicate Managers to the subscribers, and such notice shall be by letter to the subscribers in the United States and by cable or letter to those in Europe at the addresses of the respective subscribers written below, or at such other addresses as may be furnished in writing to the Syndicate Managers by the subscribers respectively. Each subscriber shall be called upon to pay and shall be liable only for such amount as shall bear to the total obligation payable by the Syndicate as ascertained from time to time the same ratio or proportion as his subscription hereunder written bears to the maximum obligation of the Syndicate as fixed in this agreement. The Syndicate Managers may at any time in their discretion distribute among the subscribers pro rata any securities acquired or held hereunder; but until the termination of the Syndicate, unless the Syndicate Managers shall otherwise notify the subscribers in writing, no securities so delivered to subscribers shall be sold by them, but they shall all be held by the subscribers subject to the order and control of the Syndicate Managers, to be returned to said Syndicate Managers upon demand or their order, for sale or exchange on Syndicate account.

Fourth. The Readjustment Managers shall pay to the Syndicate Managers for the benefit of the several Syndicate subscribers in proportion to their respective subscriptions a commission or compensation of three per cent (3 per cent) in cash on the amount of their subscriptions hereunder regardless of the amount which the Syndicate shall be called upon to pay or advance. Such compensation shall be paid from time to time, as the Readjustment Managers and Syndicate Managers shall determine.

Fifth. Deliveries of the respective new securities shall be made with reasonable promptness after completion of the readjustment in New York and London in such proportions as the Syndicate Managers shall request. The Syndicate shall continue in force and operation until one year after the delivery of the new securities, unless sooner terminated by the Syndicate Managers in their discretion and at their option upon notice to the subscribers.

Sixth. The Plan of Readjustment may be modified from time to time by the Readjustment Managers as provided in the Readjustment Agreement. Thereupon this agreement shall apply to such modified plan, and, if, as a result of such modification, a less amount of cash shall

be required for the purposes of the readjustment, the amount of any class or classes of securities to be sold as specified in Paragraph Second, may be reduced. In such case the amount to be paid by the Syndicate shall be diminished, as may be agreed upon, between the Syndicate Managers and the Readjustment Managers. The Readjustment Managers may finally abandon the plan, including all modifications thereof, and in such event this agreement shall cease to be of any future effect, and no compensation thereunder shall be due to the Syndicate; but any advance theretofore made by the Syndicate under subdivision 3 of Article Second of this agreement shall be repaid with interest at the rate of six per cent per annum, and any securities theretofore purchased and then held for Syndicate account may thereafter be sold and the proceeds distributed among the Syndicate subscribers at such time or times and in such amounts as the Syndicate Managers shall determine, not later, however, than one year after the final abandonment of the plan.

Seventh. The failure of any Syndicate subscriber to perform any of his undertakings hereunder shall not affect or release any other Syndicate subscriber, and upon such failure the Syndicate Managers shall have the right at their option to exclude such subscriber from further interest and participation in the Syndicate and to forfeit any payments he may have theretofore made thereunder, and to recover all damages resulting from his failure. The Syndicate Managers may in their discretion by written consent release any subscriber, and may accept new subscribers from time to time in the place of any subscriber so failing or released. Each subscriber shall be liable hereunder solely to the Syndicate Managers and the Readjustment Managers and their assigns and only for such ratable part of the obligations of the Syndicate as the amount of his subscription bears to $25,000,000. Nothing contained in this agreement or otherwise shall constitute the subscribers partners with one another or with the Syndicate Managers or render them liable to contribute in any event more than their ratable amount as aforesaid. The Readjustment Managers shall in no event be personally liable in respect to any loss incurred hereunder.

Eighth. All the bonds and stocks purchased by the Syndicate as aforesaid, and all net proceeds resulting from the sales of any such bonds or stock, or from any other transaction of the Syndicate Managers for account of the Syndicate under any of the provisions hereof, after payment of any and all expenses and obligations incurred by the Syndicate Managers under the provisions of this agreement, and the repayment of any advances made by the Syndicate, shall be distributed among the Syndicate subscribers pro rata by the Syndicate Managers at any time when they shall decide to terminate this agreement, or from time to time when and as the Syndicate Managers may deem expedient. The word "stock," whenever used herein to describe any securities to be deposited hereunder, shall include stock voting trust certificates.

Ninth. The Syndicate Managers may sell any bonds or stocks held hereunder to any other subscriber, and any such other subscriber may make any purchase from the Syndicate Managers. The Syndicate Managers shall have absolute control over the disposition of all stock held by them, and they may cause the same to be transferred to themselves, or as they deem expedient, to any person or persons, corporation or corporations. While so held by them or under their control the Syndicate Managers shall have the exclusive right, and discretionary power is hereby conferred upon them, to vote upon such stock or to cause the same to be voted by their nominees or by any proxies appointed or selected by them at all meetings of stockholders for the election of directors of the company, stock in which is so held, and for any and all purposes whatsoever. The Syndicate Managers shall have the sole management and conduct of the Syndicate. The subscribers therefore nominate and irrevocably appoint the Syndicate Managers their agents and attorneys, with full power and authority to do any and all acts and enter into and execute any and all agreements and arrangements deemed by the Syndicate Managers necessary, proper or expedient to carry out and perform the objects and terms of this agreement substantially as herein set forth, or to promote or protect what they may deem the best interests of the Syndicate, including full power and authority to make purchases and sales in the market, or otherwise, for account of the syndicate, of the existing bonds and stock (voting trust certificates) of the New York & Buffalo Railroad Company, or of other existing securities for which new securities are provided to be issued under the Plan; or of Certificates of Deposit or receipts for any such bonds or stock, or in coupons now or subsequently matured and unpaid belonging to any such bonds; deposits of the same under the Plan; purchases and sales of the new securities (or certificates entitling the holders to the new securities as issued), and generally to have such transactions in said existing and other bonds and stock and new securities or certificates therefor as they may deem best for the interests of the Syndicate; provided, however, that the total cash obligation to be incurred by the Syndicate for such purchases and for advances shall never exceed the sum of twenty-five million dollars ($25,000,000) at any one time as stated in Paragraph First hereof.

Tenth. To accomplish the objects and purposes of this Syndicate, each subscriber hereby ratifies and assents to any action of the Syndicate Managers taken under this agreement, and agrees to perform his undertakings hereunder from time to time promptly on the call of the Syndicate Managers to the full extent of the amount of his subscription set opposite his name hereto subscribed. The enumeration of particular or specific powers in this agreement shall not be considered as in any way limiting or abridging the general powers and discretion intended to be conferred upon and reserved to the Syndicate Managers in order to fully authorize them to do any and all

things by them in their discretion deemed necessary, proper or expedient to carry out the purposes of this agreement, and to aid, effectuate or consummate the Plan for readjusting the finances of the New York & Buffalo Railroad Company.

Eleventh. The Syndicate Managers shall not be liable under any of the provisions of this agreement or any matter connected therewith, and in like manner, the Readjustment Managers shall not be liable under any of the provisions of this agreement or any matter connected therewith, except in each instance for good faith and the exercise of reasonable diligence. The Syndicate Managers and the Readjustment Managers, and each of the above-named firms or any member of any of said firms, may respectively become Syndicate subscribers hereto, and in that event they shall be liable for their Syndicate subscriptions, and shall participate in the profits and losses of the Syndicate in the same way as and ratably with other Syndicate subscribers. All expenses of the Syndicate Managers, including counsel fees, brokerages paid in marketing bonds, &c., shall be charged to the Syndicate and all profits and losses of the Syndicate divided and borne pro rata, and each Syndicate subscriber agrees to pay to the Syndicate Managers on demand his ratable share of any such losses.

Twelfth. So far as practicable, the three firms, as such Syndicate Managers, shall act and concur in all steps and proceedings hereunder, but in event of the three firms not concurring, the concurrent action of any two of said firms shall be the action of the Syndicate Managers, and no action shall be taken except with the assent of at least two of said firms. The said firms shall each act as a co-partnership, and in case of any change in any of said firms the respective firms of Talbot & Company, Watkins & Company, and Weill & Company, or their respective successor firms as from time to time constituted, shall continue as Syndicate Managers, with all the powers, rights and title vested in the Syndicate Managers hereunder.

Thirteenth. Each and every party hereto upon reasonable request, will from time to time execute, deliver and perform all written agreements necessary or proper to carry this agreement into effect.

Fourteenth. All notices to American members of the Syndicate shall be signed by or for Watkins & Company and by or for Weill & Company, for the Syndicate Managers, but if for any reason it be impracticable to have the signature of both firms the signature of either firm shall be sufficient, provided the notice has been authorized by the Syndicate Managers, as provided in Paragraph Twelfth hereof. All notices to other members shall be sufficient if signed by or for Talbot & Company.

Fifteenth. This agreement shall be deemed to apply to and bind the legal representatives and assigns of the respective subscribers, but no assignment hereunder shall be valid unless assented to in writing by the Syndicate Managers.

Sixteenth. Nothing herein contained shall be construed as creating

any trust or obligation whatsoever in favor of the New York & Buffalo Railroad Company, or in favor of any person or corporation other than the subscribers, nor any obligation in favor of the subscribers, except only as is herein expressly provided.

Seventeenth. Six copies of this agreement shall be signed by the Syndicate Managers and the Readjustment Managers, and one of such copies lodged with each of the firms composing the Syndicate Managers and one with each of the firms composing the Readjustment Managers, and other copies may be signed by any of the subscribers, but all of the different copies so signed shall together constitute but one agreement.

In witness whereof, the parties of the first and second parts hereto have hereunto subscribed their names, and the Subscribers, parties of the third part, have hereunto subscribed their names, addresses and the amounts of subscriptions made by them respectively the day and year aforesaid.

BROWN & Co.,
JONES & Co., } *Readjustment Managers.*
SMITH & Co.,

TALBOT & Co.,
WATKINS & Co., } *Syndicate Managers.*
WEILL & Co.,

NAME OF SUBSCRIBER.	ADDRESS TO WHICH NOTICES ARE TO BE SENT.	AMOUNT OF SUBSCRIPTION.

ALBEMARLE AND BRISTOL RAILROAD COMPANY.

VOTING TRUST AGREEMENT.

Dated April 5th, 1909.

Agreement, made the 5th day of April, 1909, by and between Norcross & Co., Robinson, Cromwell & Co., and Tracy Brothers, all of New York City (hereinafter called the Managers), as Readjustment Managers under a certain plan and agreement for the readjustment of The Albemarle, Charlton, and Bristol Railroad Company, dated the 1st day of October, 1908, parties of the first part; George A. Norcross, William A. Robinson, and Edward C. Tracy (hereinafter called the Voting Trustees), parties of the second part; and holders of the trust certificates, hereinafter mentioned, parties of the third part,

Witnesseth:

Whereas, Albemarle and Bristol Railroad Company has been organized under the laws of the State of Alabama, and, pursuant to said plan and agreement of readjustment, has acquired certain railroads and property formerly of The Albemarle, Charlton, and Bristol Railroad Company; and

Whereas, said Albemarle and Bristol Railroad Company has authorized an issue of its First Mortgage Gold Bonds, payable January 1, 1939, with interest from January 1, 1909, at the rate of four per cent per annum, secured by a mortgage or deed of trust dated April 5, 1909, to Interborough Trust Company of New York, as Trustee, on certain of its railroads and property; and has also authorized an issue of its First Consolidated Mortgage Gold Bonds, payable January 1, 1959, with interest from January 1, 1909, at the rate of four per cent per annum, secured by a mortgage or deed of trust dated April 5, 1909, to Mutual Trust Company of New York, as Trustee, on its railroads and property; and

Whereas, in pursuance of said plan and agreement of readjustment, the Managers, as additional protection to said mortgage bonds, have delivered to the Voting Trustees certificates for two hundred and ninety-nine thousand, nine hundred and fifty full-paid shares, of one hundred dollars each, of the capital stock of Albemarle and Bristol Railroad Company, and said certificates, together with such other similar certificates as hereafter from time to time may be delivered hereunder, are to be held and disposed of by the Voting Trustees under and pursuant to the terms and conditions hereof;

Now, therefore, the Voting Trustees do agree with the Managers, and with each and every holder of certificates issued as hereinafter provided, as follows:

First: The Voting Trustees will from time to time, upon request, cause to be issued to the Managers, or upon their order, in respect of all certificates of stock received from them, certificates in substantially the following form:

[Here take in form of trust certificate.]

Second: On the first day of January, 1914, if Albemarle and Bristol Railroad Company shall then have paid, for two consecutive years, a four per cent cash dividend on its stock, or, if not, then as soon as such dividend shall for two consecutive years have been so paid; or whenever, although prior to the payment of such dividends, the Voting Trustees shall decide to make such delivery, the Voting Trustees, in exchange for and upon surrender of any trust certificate then outstanding, will, in accordance with the terms hereof, deliver certificates of stock of Albemarle and Bristol Railroad Company, and may require the holders of trust certificates to exchange them for certificates of stock.

Third: The Voting Trustees possess and shall be entitled to exercise until the actual delivery of certificates of stock in exchange for trust certificates, all rights and powers of owners of said stock including the unrestricted right to vote for every purpose and to consent to any corporate act of said Railroad Company, it being expressly stipulated that no voting right passes by or under said trust certificates, or by or under this agreement, or by or under any agreement express or implied. The Voting Trustees will not, however, during the pendency of this agreement, vote in respect of the shares of stock held by them to authorize any mortgage, additional to the First Mortgage and the First Consolidated Mortgage of said Railroad Company, upon the property acquired under said plan and agreement of readjustment dated October 1, 1908, or to authorize the issue of preferred stock of said Railroad Company, except with the consent in each instance of the holders of trust certificates representing a majority of the whole amount of the stock of said Railroad Company held by the Voting Trustees, such consent to be given in person or by proxy at a meeting called by the Voting Trustees for that purpose.

Fourth: The trust certificates issued hereunder shall be transferable upon the books of the Voting Trustees by the registered holder, either in person or by attorney, on surrender of the trust certificates, properly indorsed, and according to the rules established by the Voting Trustees for the regulation of transfers. Until so transferred, every registered holder for the time being of every such trust certificate may be treated by the Voting Trustees as the owner thereof for all purposes whatsoever.

Fifth: So long as any trust certificate is properly outstanding the registered holder thereof shall be entitled to the payment of a sum equal in amount to any and all dividends that have been declared on the shares held by the Voting Trustees against such trust certificates as soon as such dividends have been collected by the Voting Trustees, less such fraction of the expenses of the Voting Trustees herein provided for as the shares so held against such trust certificate are of the total number of the shares held by the Voting Trustees at the time such expenses were incurred.

Sixth: In voting the stock held by them, the Voting Trustees will exercise their best judgment from time to time in selecting suitable directors to the end that the affairs of the said Railroad Company shall be properly managed; and in voting and in taking action on other matters which may come before them as stockholders they will likewise exercise their best judgment; but they assume no responsibility in respect to such management or in respect of any action taken pursuant to their consent thereto as such stockholders.

The Voting Trustees may execute any of the trusts or powers hereof and perform any duty hereby required by or through their attorneys, officers, agents, or servants, and shall be entitled to advice of counsel in all matters concerning the trusts hereof and their duties hereunder. The Voting Trustees shall be answerable only for their own several acts, receipts, neglects, and defaults, and not for those of each other, nor for those of any person employed by them and selected with reasonable care, nor for loss unless the same shall happen through the individual wilful default of the individual trustee charged therewith.

The Voting Trustees shall be authorized in all cases to pay such reasonable remuneration as they shall deem proper to all attorneys, officers, agents, and employees that they may reasonably employ in the management of the trusts and powers hereof, and all such remuneration and all other reasonable expenses and disbursements of the Voting Trustees including their own reasonable remuneration shall be paid out of dividends received in respect of the shares of stock held by them.

Any Voting Trustee may act as a director or officer of the said Railroad Company.

Seventh: Any Voting Trustee may, at any time, resign by delivering to the other Voting Trustees his resignation in writing to take effect ten days thereafter; and, in every case of death or resignation or of the inability of any Voting Trustee to act, the vacancy so occurring shall be filled as follows: the successor or successors from time to time of George A. Norcross shall be appointed by Norcross & Co., or the successors of said firm; the successor or successors from time to time of William A. Robinson shall be appointed by Robinson, Cromwell & Co., or the successors of said firm; the successor or successors from time to time of Edward C. Tracy shall be appointed by

Tracy Brothers, or the successors of said firm, the instruments of appointment being lodged with the other Voting Trustees. The term Voting Trustees, as herein used, shall apply to the parties of the second part and their successors hereunder.

Eighth: All action to be taken by, or questions arising among, the Voting Trustees from time to time shall be determined by the decision of a majority of those then acting as Voting Trustees. Such decision may be evidenced by a writing signed by the Voting Trustees, or a majority thereof, and, if so evidenced, no meeting of the Voting Trustees for the purpose of considering the matter so decided shall be requisite.

Ninth: All notices to be given to the holders of trust certificates shall be mailed to such holders at the addresses last furnished by them to the Voting Trustees, provided they shall have furnished addresses. No holder of a trust certificate who fails to furnish an address to the Voting Trustees shall be entitled to receive any notice from the Voting Trustees of any proceedings taken hereunder.

Tenth: The term Albemarle and Bristol Railroad Company for the purpose of this agreement, and for all rights hereunder, including the issue and delivery of stock, shall be taken to mean the said corporation organized under the laws of the State of Alabama or any successor or consolidated corporation.

Eleventh: From time to time hereafter, the Voting Trustees may receive certificates for additional full-paid shares of the stock of said Railroad Company, and, in respect of all such certificates so received, the Voting Trustees may issue and deliver trust certificates similar to those above mentioned, entitling the holders to the rights therein specified.

In witness whereof, the parties of the first and second parts have hereunto set their hands in the city of New York the day and year first above written. This agreement shall become binding upon the holders of trust certificates upon their acceptance of such certificates.

Norcross & Co.,
Robinson, Cromwell & Co.,
Tracy Brothers,
Readjustment Managers.

George A. Norcross,
William A. Robinson,
Edward C. Tracy,
Voting Trustees.

Certificate for less than 100 shares

Number *D 3*

Shares *10*

Certificate for less than 100 shares

CONSOLIDATED STEEL COMPANY

Incorporated under the laws of the State of New Jersey.

AUTHORIZED CAPITAL:

Preferred Stock $20,000,000 **Common Stock $20,000,000**

Shares $100 each.

Registered: April 28, 1909,
New Jersey Bonding Company, Registrar of Transfers.
By C. W. McIlvaine, Assistant Secretary.

This Certifies that ________ *John Adams* ________ is the registered holder of ________ *ten* ________ full-paid shares of the **Common Stock** of Consolidated Steel Company, transferable only on the books of the Company by the holder in person, or by attorney, on surrender of this certificate, properly indorsed.

The shares above described are a part of a total common stock of twenty million dollars, authorized by the amended certificate of incorporation of the Company filed in the office of the Secretary of State of New Jersey on the twenty-sixth day of April, 1909. A total preferred stock of twenty million dollars is also authorized by the said amended certificate.

The Preferred Stock, as more fully provided in said amended certificate, is entitled, in preference to the Common Stock, to cumulative dividends at the rate of seven per centum yearly, and on distribution of assets to payment of its par value and the amount of such cumulative dividends then unpaid, but to no other dividend or payment.

This certificate shall not be valid unless countersigned by the Transfer Agent, and by the Registrar of Transfers.

Witness the seal of the Company and the signatures of its duly authorized officers, this 27th day of April, 1909.

Hugh Knowles, Assistant Treasurer. { Seal of Consolidated Steel Company } Philip Livermore, Vice-President.

Countersigned: April 28, 1909,
Security Trust Company, Transfer Agent.
By G. E. Goodspeed, Treasurer.

For value Received________hereby sell, assign, and transfer unto

____

____shares

of the Capital Stock represented by the within Certificate and do hereby irrevocably constitute and appoint________________________ Attorney, to transfer the said stock on the Books of the within named Company with full power of substitution in the premises.

*Dated*____________________19_____.

____

In presence of

Certificate for less than 100 shares

Number *17*

CONSOLIDATED STEEL COMPANY

Shares *10*

Certificate for less than 100 shares

Incorporated under the laws of the State of New Jersey.

AUTHORIZED CAPITAL:

Preferred Stock $20,000,000 **Common Stock $20,000,000**

Shares $100 each.

This Certifies that ________________________ *James Wakefield* ________________________ is the registered holder of ________________ *ten* ________________ full-paid shares of the **Preferred Stock** of Consolidated Steel Company, transferable only on the books of the Company by the holder in person, or by attorney, on surrender of this certificate, properly indorsed.

The shares above described are a part of a total preferred stock of twenty million dollars, authorized by the amended certificate of incorporation of the Company filed in the office of the Secretary of State of New Jersey on the twenty-sixth day of April, 1909. A total common stock of twenty million dollars is also authorized by the said amended certificate.

The Preferred Stock, as more fully provided in said amended certificate, is entitled, in preference to the Common Stock, to cumulative dividends at the rate of seven per centum yearly, and on distribution of assets to payment of its par value and the amount of such cumulative dividends then unpaid, but to no other dividend or payment.

This certificate shall not be valid unless countersigned by the Transfer Agent, and by the Registrar of Transfers.

Witness the seal of the Company and the signatures of its duly authorized officers, this 27th day of April, 1909.

Hugh Knowles, Assistant Treasurer. { Seal of Consolidated Steel Company } Philip Livermore, Vice-President.

Registered: April 28, 1909,
New Jersey Bonding Company, Registrar of Transfers.
By C. W. McIlvaine, Assistant Secretary.

Countersigned: April 28, 1909,
Security Trust Company, Transfer Agent.
By G. E. Goodspeed, Treasurer.

For value Received________hereby sell, assign, and transfer unto

____

____shares

of the Capital Stock represented by the within Certificate and do hereby irrevocably constitute and appoint________________________ Attorney, to transfer the said stock on the Books of the within named Company with full power of substitution in the premises.

*Dated*____________________19_____.

____

In presence of

CONSOLIDATED STEEL COMPANY

FIRST MORTGAGE TWENTY YEAR FIVE PER CENT. GOLD BOND

No. M 1783 **$1000**

Consolidated Steel Company, a corporation created under the laws of the State of New Jersey, for value received hereby promises to pay to the bearer or, if registered, to the registered holder hereof, on the first day of January, 1929, at the office of Black and Company, or the successors of said firm, in the city of New York,

ONE THOUSAND DOLLARS

in gold coin of the United States of America of or equal to the present standard of weight and fineness, and to pay interest thereon from the 1st day of January, 1909, at the rate of five per cent. per annum in like gold coin semi-annually on the first days of January and July in each year at said office upon presentation and surrender of the coupons hereto annexed as they severally mature.

Both the principal and interest of this bond are payable without deduction for any tax or taxes which the company may be required to pay or to retain therefrom under any present or future law of the United States of America or of any state, county, or municipality thereof, the company hereby agreeing to pay all such tax or taxes.

This bond is one of a series of bonds known as the First Mortgage Five Per Cent. Gold Bonds of the company, all of which bonds have been issued or are to be issued under and in pursuance of, and are to be secured ratably by, a mortgage or deed of trust bearing date the 27th day of April, 1909, executed by the company to Interborough Trust Company of New York, as Trustee, known as the First Mortgage. Said bonds are numbered from one consecutively upwards and are limited to the principal sum of twenty million dollars ($20,000,000) at any one time outstanding. For a description of the properties mortgaged, the nature and extent of the security, the rights of the holders of bonds, and the terms and conditions upon which bonds of said series may be issued and are secured, reference is made to the said First Mortgage.

This bond is subject to redemption at the option of the company on six months' notice on January 1st, 1919, or at any interest day thereafter, at five per cent. premium and accrued interest as provided in the said First Mortgage.

This bond may, at the holder's option, be registered as to the principal thereof on the books of the company at its transfer agency in the city of New York, and be made payable only to the registered holder named therein, but such registration shall not affect the negotiability of the coupons by delivery. After such registration, certified hereon, no transfer except on the books of the company shall be valid, unless the last transfer on said books shall have been to bearer and transferability by delivery thereby restored; but successive registrations and transfers to bearer as aforesaid may be made at the option of the holder.

Neither this bond nor any coupon for interest thereon shall become valid or obligatory until the certificate indorsed hereon has been duly executed by the Trustee under said First Mortgage.

In Witness Whereof, the company has caused these presents to be signed by its president or a vice-president, and its corporate seal to be hereunto affixed and attested by its secretary or an assistant-secretary, and coupons for such interest with the engraved facsimile signature of its treasurer to be hereunto attached this 27th day of April, 1909.

CONSOLIDATED STEEL COMPANY.

Attest:
Hugh Knowles,
Secretary.

{ Seal of Consolidated Steel Company }

By Philip Livermore,
Vice-President.

NOTICE: No Writing on this Bond, Except by the Registrar of the Company

DATE OF REGISTRY	IN WHOSE NAME REGISTERED	REGISTRAR

No. M 1783

CONSOLIDATED STEEL COMPANY

First Mortgage Twenty Year Five Per Cent.
Gold Bond

$1000

ISSUED UNDER AND SECURED BY DEED OF TRUST TO

Interborough Trust Company of New York, *Trustee*

Dated, APRIL 27, 1909

PRINCIPAL DUE 1929

INTEREST PAYABLE SEMI-ANNUALLY ON THE FIRST DAYS OF

JANUARY AND JULY

AT OFFICE OF

BLACK & COMPANY, NEW YORK

Trustee's Certificate

This is to Certify that this bond is one of a series of bonds of Consolidated Steel Company mentioned in the deed of trust within referred to.

Interborough Trust Company of New York,
By GEORGE C. ALLEN, *Vice-President.*

Consolidated Steel Company. $25

On the 1st day of July, 1909, Consolidated Steel Company, a New Jersey corporation, will pay to bearer at the office of Black and Company in the city of New York twenty-five dollars ($25) in gold coin, without deduction for taxes, for six months' interest then due on its First Mortgage Gold Bond, No. M 1783

JOHN G. HOLMES, *Treasurer.* 40

Certificate for less than 100 shares

Number *192*

ALBEMARLE AND BRISTOL RAILROAD COMPANY

Shares *10*

Certificate for less than 100 shares

Incorporated under the laws of the State of Alabama.

TRUST CERTIFICATE.

This Certifies that as hereinafter provided, and on surrender hereof ______ *George Ladd* ______ will be entitled to receive a certificate or certificates for ______ *ten* ______ full-paid shares of $100 each of the capital stock of Albemarle and Bristol Railroad Company and in the meantime to receive payments equal to the dividends, if any, collected by the undersigned Voting Trustees upon a like number of such shares standing in their names, less a proper share of the expenses of the Voting Trustees.

Until after the actual delivery of such certificates, the Voting Trustees shall possess, and shall be entitled to exercise, all rights and powers of owners of said stock, including the right to vote for every purpose and to consent to any corporate act of said Railroad Company, except as provided in the agreement, dated the 5th day of April, 1909, hereinafter referred to; it being expressly stipulated that no voting right passes by or under this certificate, or by or under any agreement, express or implied.

This certificate is issued pursuant to, and is subject to the terms and conditions of, a certain agreement dated the 5th day of April, 1909, signed by Norcross & Co., Robinson, Cromwell & Co., and Tracy Brothers, as Readjustment Managers, and the undersigned Voting Trustees, which agreement more fully defines the rights of the holder hereof, and the rights, duties and liabilities of the Voting Trustees.

No certificates of stock shall be deliverable hereunder before the 1st day of January, 1914, nor until the expiration of such further period, if any, as shall elapse before the said Railroad Company shall have paid for two consecutive years a four per cent. cash dividend on its stock. The Voting Trustees may, however, make delivery at any earlier date in their discretion, as provided in said agreement.

This certificate is transferable only on the books of the Voting Trustees by the registered holder, either in person or by attorney, upon surrender of this certificate properly indorsed, and according to the rules established by the Voting Trustees for the regulation of transfers; and until so transferred the Voting Trustees may treat the registered holder as owner hereof for all purposes whatsoever.

This certificate is not valid unless duly signed on behalf of the undersigned Voting Trustees by Norcross & Co., their agents, and also registered by Interborough Trust Company of New York as registrar of transfers.

In witness whereof the said Voting Trustees have caused this certificate to be signed by Norcross & Co., their duly authorized agents, this 6th day of April, 1909.

George A. Norcross,
William A. Robinson,
Edward C. Tracy,
Voting Trustees,
by their Agents hereunder,
Norcross & Co.

Registered: April 6, 1909.
Interborough Trust Company of New York, Registrar of Transfers,
By M. Kim, Assistant Secretary.

For value received ________ hereby sell, assign, and transfer unto

____

____ the within certificate subject to the terms and conditions of the Voting Trust Agreement within referred to, and of all rules concerning such transfer which may from time to time or at any time be established by the within named Voting Trustees, to which agreement and rules the transferee and every holder hereof does assent by the acceptance hereof, and do appoint ________________________________ attorney to transfer said certificate on the books of said Voting Trustees accordingly, with full power of substitution in the premises.

Dated __________________ 19_____.

____

In presence of

The Riverside Press
CAMBRIDGE · MASSACHUSETTS
U · S · A